IN THE

Supreme Court of the United States

OCTOBER TERM, 1974

No. 74

EASTERN KENTUCKY WELFARE RIGHTS ORGANIZATION, *ET AL.*,

Petitioners,

v.

WILLIAM E. SIMON, SECRETARY OF THE TREASURY, *ET AL.*,

Respondents.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE DISTRICT OF COLUMBIA CIRCUIT

MARILYN G. ROSE
JOSEPH N. ONEK
Center for Law and Social Policy
1751 N Street, N.W.
Washington, D.C. 20036

Attorneys for Petitioners

TABLE OF CONTENTS

Page

CASES AND AUTHORITIES i
OPINIONS BELOW 1
JURISDICTION 2
QUESTIONS PRESENTED 2
STATUTES INVOLVED 3
STATEMENT 3
REASONS FOR GRANTING THE WRIT 7
Summary of Reasons 7
Reasons 8
CONCLUSION 19
APPENDICES 1a
App. A. Order on en banc suggestion 1a
App. B. Order on rehearing request 6a
App. C. Opinion of Court of Appeals 7a
App. D. Memorandum Opinion of District Court 33a
App. E. Memorandum Order of District Court 58a
App. F. Judgment of District Court 61a
App. G. Statutes 64a
App. H. Rev. Ruling 69-545 ..... 67a
App. I. Rev. Ruling 56-185 ..... 73a
App. J. Income Levels for Eligibility for Medicaid 77a

CASES AND AUTHORITIES

Cases:

Alexander v. Americans United,
____ U.S. ____ 94 S.Ct. 2038 (1974) 2

Bob Jones University v. Simon,
____U.S.____94 S.Ct. 2038 (1974) 2

Camp v. Pitts,
411 U.S. 138 (1973) 13

Cases: (continued): *Page*

Chapman v. Berkshire Medical Center,
Civ. 74-1954F (D.Mass.) 18

Citizens to Preserve Overton Park v. Volpe,
401 U.S. 402 (1971). 8, 11, 12

Commissioner of Internal Revenue v. Battle Creek,
126 F.2d 405 (5th Cir., 1942) 13

Davis Hospital,
4 CCH Tax Ct. Memo. 312 (1945) 14

Goldsby King Memorial,
3 CCH Tax Ct. Memo. 693 (1944) 14

Green v. Connally,
330 F.Supp. 1150 (D.D.C., 1970) aff'd per curiam sub nom.
Coit v. Green, 404 U.S. 997 (1971) 2

Harding Hospital Inc. v. United States,
505 F.2d 1068 (6th Cir., 1974). 14

Hart v. Taylor,
301 Ill. 344, 133 N.E. 857, 858 (1922) 15

Hou Ching Chow v. Attorney General,
362 F.Supp. 1288 (D.D.C., 1973) 10

Intercity Hospital Association v. Squire,
56 F.Supp. 472, 474 (W.D.Wash., 1944) 13-14

Kelly v. U.S. Department of Interior,
339 F.Supp. 1095 (E.D.Cal., 1972) 10

Lewis-Mota v. Secretary of Labor,
469 F.2d 478, (2d Cir., 1972). 8, 9

Lorain Avenue Clinic,
31 T.C. 141 (1958) 14

Lugo et al., v. Simon, et al.,
C74-345, NDOhio 18

McGlotten v. Connally,
338 F.Supp. 448, 456 (D.D.C., 1972) 2

Memorial Hospital v. Maricopa County,
___U.S.___ 94 S.Ct. 1076, 1083 (1974) 12

NLRB v. Wyman-Gordon,
394 U.S. 749 (1969) 7, 9, 10

Cases: (continued): *Page*

National Motor Freight Traffic Association v. U.S.,
268 F.Supp. 90 (D.D.C., 1967) aff'd per
curiam, 393 U.S. 18 (1968) 10

O'Brien v. Physician's Hospital,
96 Ohio St. 1, 116 N.E. 975, 977 (1917) 15

Pharmaceutical Manufacturers Association v. Finch,
307 F.Supp. 858 (D.Del., 1970) 10

Robert C. Olney,
17 CCH Tax Ct. Memo. 982 (1958) 14

Seaboard World Airlines, Inc. v. Gronouski,
230 F.Supp. 44 (D.D.C., 1964) 10

Scenic Hudson Preservation Conference v. Federal
Power Commission,
354 F.2d 608, 612, 620 (C.A. 2, 1965) (2d Cir., 1965). 11, 12

S.E.C. v. Chenery Corp.,
318 U.S. 80 (1943) 12-13

Shannon v. Department of Housing and
Urban Development,
436 F.2d 809, 819-20 (3d Cir., 1970). 11, 12

Sonora Community Hospital,
46 T.C. 519 (1966) 14

Texaco, Inc. v. Federal Power Commission,
412 F.2d 740 (3d Cir., 1969). 8, 9

Statutes:

5 U.S.C.:
Sec. 553 ..... 3, 6, 8, 9, 10
Sec. 706(2)(A) 3

26 U.S.C.:
Sec. 170(a)-(c) 3
Sec. 501(c)(3) 3
Sec. 7421(a) 2

National Health Planning and Resources Development
Act of 1974, P.Law 93-641, sections 1602(5) and (6),
1604(b)(1)(J), 1612(c), 93rd Cong., 2d Sess. 18

Legislative Histories: *Page*

House Report No. 1860, 75th Cong., 3rd Sess. 19-20 (1939) 11

Regulations:

Treas. Reg. §1.501(c)-1(d)(2) 11
42 CFR 53.111 18

Revenue Rulings:

Rev. Rul. 56-185, 1956-1 Cum. Bull. 202 ..... 14, 16
Rev. Rul. 69-545, 1969-2 Cum. Bull. 117 ..... 5, 6, 7, 11, 14, 15

Governmental Writings:

Bureau of the Census, 1970 Census, *General Social and Economic Characteristics, U.S. Summary*, PC(1)-C1, Table 182 16

Division of Evaluation, Medical Services Administration, DHEW, "Income and Resources Levels for Medically Needy," DRAFT, Dec. 1974 17

Towards A Comprehensive Health Policy for the 1970's, A White Paper, May 1971, U.S. Department of Health, Education and Welfare 16

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PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE DISTRICT OF COLUMBIA CIRCUIT

Eastern Kentucky Welfare Rights Organization and other organizations and poor individuals petition for a writ of certiorari to review the judgment of the United States Court of Appeals for the District of Columbia Circuit entered in this case on October 9, 1974.

OPINIONS BELOW

The opinion of the Court of Appeals (Appendix C, *infra*, pp. 7a-32a) is reported at 506 F.2d 1278. The memorandum opinion of the District Court (Appendix D., *infra*, pp. 33a-

57a) is reported, *sub nom. Eastern Kentucky Welfare Rights Organization, et al., v. Shultz et al.*, at 370 F. Supp. 325. An additional memorandum order (Appendix E, *infra*, pp. 58a-60-a) and the Judgment (Appendix F, *infra*, pp. 61a-63a) are unreported.

JURISDICTION

The judgment of a divided Court of Appeals for the District of Columbia Circuit, reversing the District Court, was entered on October 9, 1974. A timely petition for rehearing was denied, with dissent (Appendix B, *infra*, p. 6a) as was the suggestion for rehearing *en banc*, with three dissents, on December 6, 1974 (Appendix A, *infra*, pp. 1a-5a). On application filed by the Solicitor General, the Chief Justice extended the time for filing a petition for a writ of certiorari to and including March 8, 1975.[1] The jurisdiction of this Court is invoked under 28 U.S.C. § 1254(1).

QUESTIONS PRESENTED

(1) Whether Respondents, the Secretary of the Treasury and the Commissioner of Internal Revenue, in issuing rules which have a substantial impact upon an industry and

[1] Although the panel majority decided the merits of the case in favor of the Federal officials, all three Judges decided certain jurisdictional issues in favor of petitioners, concerning the applicability of the Tax Injunction Act (26 U.S.C. 7421(a)), the exclusionary clause of the Declaratory Judgment Act pertaining to matters involving Federal taxes (28 U.S.C. 2201), and the doctrine of sovereign immunity, finding the restrictions in those provisions and doctrine inapplicable to the instant case. Compare *Green v. Connally*, 330 F.Supp. 1150 (D.D.C., 1970), aff'd *per curiam sub nom. Coit v. Green*, 404 U.S. 997 (1971) and *McGlotten v. Connally*, 338 F.Supp. 448, 456 (D.D.C., 1972) with *Bob Jones University v. Simon*, _____ U.S. _____, 94 S.Ct. 2038, (1974) and *Alexander v. Americans United*, _____ U.S. _____ 94 S.Ct. 2038 (1974).

rights of a large segment of the public, and alter the legal obligations of that industry to that segment of the public, must follow tthe rule-making requirements of the Administrative Procedure Act (5 U.S.C. 553);

(2) Whether Respondents have violated the Internal Revenue Code by the issuance of an *ad hoc* ruling, eliminating the long-standing requirement that non-profit hospitals provide service to the indigent as a condition of obtaining the status and benefits accorded to "charitable" institutions under the Internal Revenue Code (26 U.S.C. 501((c)(3) and 170(a)-(c));

(3) Whether Respondents could issue a ruling which eliminates the obligations of "charitable" tax exempt hospitals to serve the indigent, without consideration of all relevant factors, including its impact upon the ability of millions of poor persons to obtain hospital services, and the policies and views of Congress and the health agency of the United States which continue to require hospitals to serve the indigent.

STATUTES INVOLVED

The relevant portions of the Internal Revenue Code (26 U.S.C. 501(c)(3) and 170(a)-(c)) and the Administrative Procedure Act (5 U.S.C. 553 and 706(2)(A)) appear in pertinent part in Appendix G to this Petition (pp. 64a-66a, *infra*).

STATEMENT

The Internal Revenue Code, since its inception, has provided tax exemption for the income of, and permitted donors to deduct contributions to, certain organizations categorized as "charitable". (See 26 U.S.C. 501(c)(3) and 170(a)-(c)). Although other organizations categorized as "educational" and "religious" have always been accorded the same benefits as "charitable" organizations, and

"scientific" and "literary" organizations subsequently have been granted similar treatment by Congress, nonprofit hospitals and other nonprofit health institutions have never been granted the same independent status under these provisions of the Code but have only qualified for tax benefits if they fit into the "charitable" category.[2]

The long established position of the Federal Courts, Congress, and the Internal Revenue Service has been that, in order to quality as "charitable" organizations under the Code, nonprofit hospitals must provide service to persons unable to pay and may not limit services exclusively to those able to pay. On October 8, 1969, the Commissioner of Internal Revenue issued a published revenue ruling to the effect that nonprofit hospitals would be eligible for charitable status if they are "operated for the care of all those persons in the community able to pay the cost thereof either directly or through third party reimbursement" and "remove(d) . . . the requirements relating to caring for patients without charge or at rates below cost." (Revenue Ruling 69-545, 1969-2 Cum. Bull. 117, see App. H, *infra*, pp. 67a-72a). This reversal of a long-held requirement was issued without notice to the public or any opportunity to the public and/or interested and affected persons to contest the matter. The ruling, on its face, is totally devoid of any consideration of the needs of indigent persons for hospital services or the number of such persons who, by virtue of the ruling, would be stripped of pre-existing rights for services from tax exempt hospitals.

Petitioners are extremely poor people, and organizations representing poor people, with incomes at or below the

[2] On two occasions amendments were proposed in Congress which would have accorded health institutions (in 1924) and hospitals (in 1969) favorable tax status independent of "charitable" services, but on both occasions the attempt failed. For discussion see District Court Memorandum Opinion, 370 F.Supp. 325, at 331-2, *infra*, pp. .

minimal poverty line guidelines and without health insurance or resources to pay for hospital care. (J.A. 9-11, 13-16). The uncontradicted Affidavits in the record below (J.A. 69-108) recount incidents in various locations across the country since 1969 in which they and other indigent persons were denied needed hospital attention because of their inability to pay for services by institutions which refuse to serve persons unable to pay but still retain their status under the Code as "charitable" institutions in accordance with Revenue Ruling 69-545.

After failing to obtain a reconsideration of the issues underlying Revenue Ruling 69-545, in particular the lack of available hospital services for poor people, and being told by representatives of the Internal Revenue Service and the Department of the Treasury that they were addressing themselves to the wrong forum (J.A. 67-68), Petitioners commenced this action in July 1971. They alleged, *inter alia*, that the Commissioner of Internal Revenue and the Secretary of the Treasury had violated the Internal Revenue Code and the Administrative Procedure Act by the issuance of Revenue Ruling 69-545, which eliminated the requirement that nonprofit hospitals provide services to the indigent in order that they may retain their "charitable" status under the Code, and thus deprived them of their pre-existing rights to obtain services from nonprofit hospitals. The District Court held that they had standing to maintain the action and that it had jurisdiction under 28 U.S.C. 1331, 1340, 1361, 2201, and 2202.

On cross-motions for summary judgment, the District Court held that Revenue Ruling 69-545 violated the Internal Revenue Code. In reaching its decision the District Court relied upon the long-standing judicial authority and the legislative history, which established that nonprofit hospitals must provide service to the indigent in order to retain their status as "charitable" institutions under the Code. In view of that holding, the Court did not decide

whether the peremptory issuance of the ruling also violated the Administrative Procedure Act.

A divided panel in the Court of Appeals reversed the District Court. While acknowledging that in the past Congress and federal courts had conditioned a hospital's "charitable" status on the level of free or below cost care that it provided for indigents, the majority concluded that there was no authority for the conclusion that the determination of "charitable" status was always to be so limited. Despite the total lack of any record that IRS considered the impact of the ruling upon poor people needing hospital services, and despite the admission by respondents' counsel in their brief to the Court of Appeals that IRS lacks expertise in the health area (C.A. Brief, p. 72), the panel majority concluded that IRS could have determined that Revenue Ruling 69-545 may be of greater benefit to the poor than the prior position. Relying upon the same authority as did IRS (i.e., Scott on Trusts and the Restatement of Trusts), the panel majority held that Revenue Ruling 69-545 was founded upon a permissible definition of the term "charitable". The majority also accepted the characterization by respondents that the ruling was "interpretative" and therefore not subject to the rule-making requirements of section 553 of the APA nor an "abuse of discretion" under section 706(2)(A) of the APA.

The dissenting judge stated that he would affirm the District Court for the reasons stated in its opinion and would also, alternatively, hold that the issuance of Revenue Ruling 69-545 worked a substantial change in the availability of hospital services to the poor without, admittedly, giving the poor or anyone else notice and an opportunity to comment upon it as required by section 553 of the Administrative Procedure Act. Over three dissents, review *en banc* was denied.

REASONS FOR GRANTING THE WRIT

Summary of Reasons

The Court below has decided federal questions affecting the availability of hospital services for some 20-40 million poor persons.[3] Its ruling that a federal agency can so determine the obligations of an entire industry and the rights of a large segment of the public dependent upon the industry without notice or opportunity for comment is an intolerable expansion of the "interpretative ruling" exception to the Administrative Procedure Act requirements for rule-making proceedings — an expansion inconsistent with rulings of other Circuits and the guidelines established by this Court in *NLRB v. Wyman-Gordon Co.*, 394 U.S. 759 (1969).

Furthermore, the IRS has upset practices of more than 30 years' standing in this field without so much as considering the policies or views of Congress or the federal agency charged with primary responsibility for health care, the Department of Health, Education and Welfare, which continue to require that hospitals serve the indigent. Compounding the incompleteness of the administrative record, the court interjected its own speculation that the revenue ruling "may be of greater benefit to the poor than its predecessor . . ." (App. C, *infra*, p. 27a). Matters of such public moment must be decided on a clear record developed in appropriate administrative proceedings.[4] The Court below plainly violated, in this regard, the teaching of

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[3] The size of the affected class is described in point 4, *infra*, pp. -.

[4] The only record on this point is the Affidavits filed by Petitioners in District Court showing that many poor persons were denied hospital services by hospitals which denied admission to the indigent after the issuance of Revenue Ruling 69-545.

Citizens to Preserve Overton Park v. Volpe, 401 U.S. 402 (1971).

The ruling below drastically relaxes the standards for qualifications as a "charitable" organization under the Internal Revenue Code of nonprofit hospitals. It conflicts on this point with numerous rulings of other federal courts. In its own right the question of the scope of the "charitable" organization provisions of the Internal Revenue Code is one of broad general importance warranting review by this Court.

Reasons

1. The decision by the panel majority holding that the rule-making requirements of the Administrative Procedure Act (5 U.S.C. 553) do not apply to the revenue ruling in this case conflicts with the standards set forth for the application of the rule-making requirements by the Second Circuit in *Lewis-Mota v. Secretary of Labor*, 469 F.2d 478 (1972) and by the Third Circuit in *Texaco Inc. v. Federal Power Commission*, 412 F.2d 740 (1969) and by other federal courts. These cases establish that the procedure set forth in section 553 must be followed in connection with an agency rule which departs from a long-established and judicially approved position and eliminates the rights of a large segment of the public.

The Administrative Procedure Act (5 U.S.C. 553) requires that an agency which engages in rule-making must do so by a general notice in the Federal Register which includes the terms or substance of the proposed rule or a description of the subjects and issues involved, and that such agency shall give interested persons an opportunity to participate in the rule-making process through submission of written data, views, and arguments. No less than thirty (30) days notice must be given before the rule is effective. The purpose of this requirement is to assure that agencies

consider all relevant facts and the impact upon society in exercising the legislative functions delegated to them by Congress.

There are a number of exceptions to the rule-making requirements; for rules which are "interpretative" rather than "legislative", which constitute a "general statement of policy", which involve agency procedure, or which are so minor in nature that publication for pre-effective date comment is "unnecessary." In determining whether one of these exceptions applies to a particular rule, other federal courts have rejected the label which the agency itself puts on the rule and rather have looked to what the rule in fact has done. These several courts have held that the rule is subject to the requirements of section 553, despite its label, upon an affirmative finding of one or more of the following criteria: (1) does the rule "create" law; (2) does the rule have a substantial impact upon the regulated industry; (3) does the rule have a substantial impact upon the public; (4) is there a drastic change in the law as it existed before the rule was issued; (5) is there a need for the agency to educate itself.

Thus, the Second Circuit in *Lewis-Mota v. Secretary of Labor*, 469 F.2d 478, 481-2 (1972) held that a rule which "changed existing rights and obligations" and had a "substantial impact" upon segments of the public was subject to the requirements of section 553. So too did the Third Circuit in *Texaco v. Federal Power Commission*, 412 F.2d 740, 744 (1968), cited by the dissent in the instant case. Both Circuits also found need for the agencies to educate themselves before establishing rules and procedures which have a substantial impact on those regulated, under the rationale of *NLRB v. Wyman-Gordon Co.*, 394 U.S. 759 (1969). Similar reasoning has been applied by a number of district courts

to strike down agency rules promulgated without regard to the requirements of section 553.[5]

Implicit in these decisions is the fundamental notion that before a governmental agency acts with impact upon existing rights and legitimate expectations of people, the government must give those people an opportunity to be heard. Section 553 of the APA is the mechanism which Congress has chosen for that function. See, *NLRB v. Wyman-Gordon Co.*, 394 U.S. 759 (1969).

The panel majority ignored the effect that Revenue Ruling 69-545 had upon the availability of hospital services for millions of persons without the means to pay for in-patient care at hospitals by, an agency which was admittedly not an expert in health care delivery problems and thus needed to be educated. While recognizing that the ruling reversed the long-standing position of IRS as well as the established position of the federal courts on the subject, the panel majority found the criteria applied by the Third and Second Circuits irrelevant because the agency contended that the ruling was "interpretative" and only legally binding if courts chose to accept the interpretation. The panel majority thus seriously departed from the principles upon which two other Circuits and other federal courts have determined whether rule-making is subject to the requirements of section 553. This conflict between the Circuits as to standards to be applied to agency rule-making action should be resolved by this Court.

2. Even if IRS was not obligated to follow the specific rule-making requirements of section 553 of the APA, the agency

[5] See, *Kelly v. Department of Interior*, 339 F.Supp. 1095 (E.D.Cal., 1972); *Pharmaceutical Manufacturers Association v. Finch*, 307 F.Supp. 858 (D.Del., 1970); *Hou Ching Chow v. Attorney General*, 362 F.Supp. 1288 (D.D.C., 1973); *National Motor Freight Traffic Association v. United States*, 268 F.Supp. 90 (D.D.C., 1967); *Seaboard World Airlines, Inc. v. Gronouski*, 230 F.Supp. 44 (D.D.C., 1964).

still was required to consider all relevant factors and indicate its conclusions in some record reviewable by the courts. E.g., *Citizens to Preserve Overton Park v. Volpe*, 401 U.S. 402, 416 (1971); *Shannon v. Department of Housing and Urban Development*, 436 F.2d 809, 819-20 3rd Cir., 1970) and *Scenic Hudson Preservation Conference v. F.P.C.*, 354 F.2d 608, 612, 620 (2nd Cir., 1965). The decision below is inconsistent with this basic precept of administrative law.

On its face Revenue Ruling 69-545 makes no reference whatsoever to a consideration of the needs of the indigent for free hospital care (See Appendix H. pp. 67a-72a, *infra*). The sole basis for the removal of the free service requirement was a reference to Scott on Trusts. Trust law, however, is concerned with private claims over the assets of a decedent which has been placed into trust into perpetuity, and not federal policy over tax exemptions[6] or the national policy which continues to require that hospitals provide free services to poor people (see point 4, *infra*). IRS never considered the factual underpinnings for the unsubstantiated conclusion "of a changed health care situation in this country" as suggested by the panel majority. There is no record that IRS ever considered the full implications of eliminating the right of the poor to in-patient services in the absence of dire medical emergencies.[7] IRS never considered the effect of eliminating in-

[6] The underlying rationale for the "charitable" tax exemption is that governments must perform certain functions if private parties do not, and thus the use of tax incentives to subsidize such work by private parties "lessens the burdens of government." See House Report No. 1860, 75th Cong., 3rd Sess. 19-20 (1939). See also Treas. Reg. 1-501(c)-1(d)(2).

[7] The Supreme Court has recognized what IRS and the panel majority did not recognize:

> "To allow a serious illness to go untreated until it requires emergency hospitalization is to subject the

(continued)

patient care as a requirement of charitable status of hospitals in "lessening the burdens of government." The uncontradicted Affidavits in the record suggest the seriousness of this omission.[8]

In *Scenic Hudson* the Second Circuit held that an agency must make its decision upon a complete record and has an affirmative duty to inquire into and consider all relevant factors. (354 F.2d at 620). In *Shannon* the Third Circuit held that an agency must utilize some institutionalized method in exercising its duties to assure that all the relevant factual information is before it. (436 F.2d at 819-20). In issuing Revenue Ruling 69-545, however, IRS did not adhere to that requirement.

This Court in *Citizens to Preserve Overton Park v. Volpe*, 401 U.S. 402, 416 (1971) already has implied an adoption of the position of the Second Circuit in *Scenic Hudson* and the Third Circuit in *Shannon*. It has furthermore made clear in *Citizens to Preserve Overton Park* and other decisions that it is improper for the courts to rely on grounds neither relied upon or developed at the administrative level, or particularly the court's own initial appraisal of the relevant economic and social considerations, to sustain federal regulations. E.g., *SEC v. Chenery Corp.*,

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[7] (continued)

> sufferer to the danger of a substantial and irrevocable deterioration in his health. Cancer, heart disease, or respiratory illness, if untreated for a year, may become all but irreversible paths to pain, disability, and even loss of life. The denial of medical care is all the more cruel in this context, falling as it does on indigents who are often without the means to obtain alternative treatment." *Memorial Hospital v. Maricopa County*, _____ U.S. _____, 94 S.Ct. 1076, 1083 (1974).

[8] In particular see the Affidavits relating to the death of Clifford Breaux, (J.A. 102-105) and those from the physicians at the publicly-operated Charity hospital in Louisiana (J.A. 109-127).

318 U.S. 80 (1943); cf. *Camp v. Pitts*, 411 U.S. 138 (1973). The speculation of the panel majority cannot subsitute for the lack of consideration of relevant factors by IRS. It represents a serious departure by this Circuit from the proper judicial role in reviewing agency action.

3. The decision by the panel majority finding permissible the elimination by respondents of the requirement that nonprofit hospitals must afford service to the indigent in order to retain their "charitable" tax status conflicts with the principles set forth in every federal and tax court decision on the subject decided since 1942. This holding is of broad public importance which warrants review by this court.

In *Commissioner of Internal Revenue v. Battle Creek*, 126 F.2d 405 (5th Cir., 1942) That Court defined a "charitable" hospital under the Code as one which may

> "... charge those able to pay for services rendered, in order to pay the expenses of the institution, *while not denying treatment to others unable to pay anything*. Such institutions are classed as charitable." (at 406). (Emphasis supplied).

The Fifth Circuit rejected the contention by the Commissioner that a hospital which charged some persons able to pay was not entitled to status as a charitable hospital under a predecessor section of the Code, as the hospital in that case did not deny treatment to other persons unable to pay. The record demonstrated that a significantly large percentage of its patients received services, on both an inpatient and outpatient basis, free or below cost.

Every subsequent decision by the tax or other federal courts on the subject since then has required that charitable hospitals do not deny admission and services to persons unable to pay. *Inter-City Hospital Association v.*

Squire, 56 F. Supp. 472 (W. D. Wash., 1944); *Davis Hospital, Inc.*, 4 CCH Tax Ct. Memo. 312 (1945); *Goldsby King Memorial*, 3 CCH Tax Ct. Memo. 693 (1944); *Lorain Avenue Clinic*, 31 T.C. 141 (1958); *Robert Olney*, 17 CCH Tax Ct. Memo. 982 (1958); *Sonora Commuunity Hospital*, 46 T.C. 519 (1966) aff'd per curiam, 397 F.2d 814 (9th Cir., 1968). See also *Harding Hospital v. United States*, 505 F.2d 1068 (6th Cir., Nov. 1974).[9] In every one of these cases the amount of free care rendered by the hospital was decisive to its retention of its "charitable" tax status.

In 1956, the IRS had codified the position in a revenue ruling (Rev. Rul. 56-185, 1956-1, Cum. Bull. 202, Appendix I, *infra*, pp. 73a-76a). That revenue ruling specifically stated that a hospital could qualify for tax exempt status only if it was "operated to the extent of its financial ability for those not able to pay for the services rendered and not exclusively for those who are able and expected to pay." However, by Revenue Ruling 69-545, the Commissioner, who in 1942 wanted to deny charitable status to hospitals which did not admit and treat *everyone* free, has legislated that charitable hospitals need not admit and treat *anyone* free, and specifically repudiated this portion of the 1956 ruling.

The panel majority acknowledged the judicial and administrative history, but upheld the departure by IRS from that position upon two bases: (1) an irrelevant and incorrect analogy to trust law that "charitable" institutions

[9] In *Harding Hospital* the Sixth Circuit, in a decision issued after the one below, while specifically avoiding the issue of the legality of Revenue Ruling 69-545 (which it noted was in issue in the instant case but had not been briefed to it), predicated its determination that the hospital was not entitled to charitable status upon an accumulation of factors, the major one being the *de minimus* amount of free service afforded to the indigent.

do not have to serve the poor,[10] and (2) a totally unsubstantiated conclusion, not based upon any record, and not even considered by IRS, that economic, social and technological precepts and values now dictate other health policies (*infra*, p. 24a).

The writ should be granted to resolve the conflict between the recent ruling by respondents found "permissible" by the District of Columbia Circuit and the principles set forth in every other relevant decision of the federal courts.

4. The panel majority has decided an important federal question which has an impact upon the availability of hospital services for some 20 to 40 million persons. It did so upon unsubstantiated conclusions which conflict with federal policy.

Although the respondents admit that their "experience in the area of health care is severely limited" (Def. Brief in the Court of Appeals, p. 72), they did not develop a record or consider the health policy of the nation as expressed by Congress and the Agency which Congress charged with administering the nation's health policy, the Department of Health, Education and Welfare. Similarly, the panel majority did not indicate how they came to their various conclusions on the current nature of the health delivery system, including that "in the final analysis, Revenue Ruling 69-545 may be of greater benefit to the poor than its

[10] The conclusions which Scott draws, and the cases upon which the claim is made that promotion of health is a charitable purpose, do not support the thesis that service to the poor is not a requirement. Many of the cases cited in the long footnote in the Scott treatise actually spell out the requirement that the poor as well as the rich be treated in charitable hospitals. *E.g.*, *Hart v. Taylor*, 301 Ill. 344, 133 N.E. 857, 858 (1922); *O'Brien v. Physicians' Hospital*, 96 Ohio St. 1, 116 N.E. 975, 977 (1917). The cases, rather than eliminating free service as an essential element, support the proposition that health is a purpose which may be charitable, provided that actual charity is bestowed.

predecessor Ruling 56-185." (App. C., p. 27a, *infra*). No consideration was given to the number of indigent persons who would be deprived of inpatient hospital care because of a lack of any public or private third party coverage, a matter which concerns HEW greatly. In this regard, in 1971, HEW commented thus:

> ". . . while employer plans cover a majority of the population, they do not protect all of the working population, particularly the working poor. In addition, some of the plans cover the workers but not their dependents. Eligibility for Medicaid also poses financial barriers. Eligibility varies widely among the States, many of which exclude the working poor and adults in families headed by a male. Under these circumstances, half of the families with incomes under $5,000 a year and two-thirds of the families with incomes under $3,000 have no insurance. Others excluded from protection are: children and mothers in low-income and middle-income families; the unemployed and their dependents; lower income self-employed people; employed people (mainly the working poor) whose employers offer no health plans; and migrant seasonal workers."[11]

[11] "Towards a Comprehensive Health Policy for the 1970's, A White Paper," May 1971, U.S. Department of Health, Education and Welfare, p. 16.

Using these figures and those of the Census Bureau from the 1970 census, (General Social and Economic Characteristics, U.S. Summary, PC(1)-C1, Table 182), there are at least 36 million persons in the United States with incomes below $5,000 a year, at least half of whom have no public or private health insurance according to HEW. Moreover an undetermined number of families with incomes between $5,000 and

(continued)

Although Medicaid theoretically was designed to provide coverage for the indigent, it has been largely confined to the categorical public assistance recipients, and in approximately half the States (by the States' option) to persons who fit into the categories but for income which, at its maximum, would not exceed 133% of the maximum grant level for the particular State. Not only are millions of equally indigent persons not covered because they do not fit into one of the categories (aid to dependent children, aid to the aged, aid to the blind, aid to the totally disabled) but in most States the maximum grant level is so low that millions of persons below the subsistence level are excluded.[12] In Louisiana, for example, where petitioners Hunter, Cook and Lampton reside, eligibility for Medicaid is limited to the welfare class, and the cut-off for eligibility for welfare, as of July 1974, was $1,464 per year (See App. J, *infra*, p. 78a).

Further, HEW and Congress have both reaffirmed the long-standing obligation of hospitals to give charitable care. While in the courts below IRS was "defending" its abandonment of the charitable obligations of hospitals to the millions of uninsured indigent and medically indigent

[11] (continued)
admission to most hospitals under Revenue Ruling 69-545. Had IRS held a rule-making hearing such information should and would have become part of the record. As suggested by the dissent, upon such a record Revenue Ruling 69-545 would not have issued.

[12] See Appendix J, *infra*, pp. 77a-79a. Note that 24 States limit their eligibility to the welfare categories. Although the other States may cover medically needy persons who would be eligible for welfare but have incomes up to 133% of the welfare level, according to the records of HEW most States with medically needy programs only include persons with incomes slightly above the welfare line. Maximum income for eligibility exists in New York, with a level of $5000 a year for a family of four (Division of Evaluation, Medical Services Administration, DHEW, Income and Resources Levels for Medically Needy, DRAFT, December 1974).

persons on the unsubstantiated claim that in large measure they no longer existed, HEW was reaffirming the charitable obligations of those hospitals (including a substantial number of nonprofit hospitals) which had received Hill-Burton construction monies. In July 1972 and June 1973 HEW promulgated regulations setting forth more specific obligations of these hospitals to serve the indigent.[13] And Congress more recently, in December 1974, reaffirmed the obligations of such hospitals by the passage of Title XVI of the Public Health Service Act, continuing the past obligations and reaffirming new obligations for all future grantees.[14]

5. A multiplicity of lawsuits may be anticipated on these issues in other federal courts. In 1974 indigent persons instituted similar action in federal district courts in Ohio and Massachusetts.[15] In other jurisdictions where the Medicaid level is low (See Appendix J *infra*, pp. 77a-79a) and/or unemployment with its consequential loss of health insurance coverage continues to rise, persons needing hospital care may be faced with non-admission by the nation's nonprofit hospitals and turn to additional federal courts for redress. The split in the court below in the instant case, and the departure from precedent exhibited by the majority, suggests that the matter is quite open. In view of the potential size and gravity of the problem, a consideration of the issues should now be undertaken by this Court.

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[13] 42 CFR 53.111.

[14] National Health Planning and Resources Development Act of 1974, P. Law 93-641, sections 1602(5) and (6), 1604(b)(1)(J), 1612(c), 93rd Cong., 2d Sess.

[15] *Lugo, et al., v. Simon, et al.*, C74-345, NDOhio; *Chapman et al., v. Berkshire Medical Center, et al.*, Civ. 74-1954F, D.Mass.

CONCLUSION

For the foregoing reasons a Writ of Certiorari should be granted.

MARILYN G. ROSE
JOSEPH N. ONEK
Center for Law and Social Policy
1751 N Street, N.W.
Washington, D.C. 20036
202/872-0670

Attorneys for Petitioners

APPENDIX A

UNITED STATES COURT OF APPEALS
FOR THE DISTRICT OF COLUMBIA CIRCUIT

No. 74-1293

EASTERN KENTUCKY WELFARE RIGHTS ORGANIZATION, ET AL

v.

WILLIAM E. SIMON, SECRETARY OF TREASURY, ET AL., APPELLANTS

Before: BAZELON, *Chief Judge;* WRIGHT, MCGOWAN, TAMM, LEVENTHAL, ROBINSON, MACKINNON, ROBB AND WILKEY, *Circuit Judges.*

Filed December 6, 1974

ORDER

Appellees' suggestion that the matter be considered *en banc* having been circulated to the full court, and there not being a majority of the judges in regular active service in favor of having this case reheard *en banc,* it is
ORDERED by the court *en banc* that appellees' aforesaid suggestion is denied.

Per Curiam

Statement of BAZELON, *Chief Judge,* with whom Circuit Judges WRIGHT and ROBINSON concur, as to why he voted to grant rehearing *en banc.*

Statement of WRIGHT, *Circuit Judge*, with whom Chief Judge BAZELON and Circuit Judge ROBINSON concur, as to why he voted to grant rehearing *en banc*.
Statement of BAZELON, *Chief Judge*, as to why he voted to grant rehearing *en banc*:

I concur in Judge Wright's dissent and statement as to why he voted to grant rehearing *en banc* on the issue of compliance with the rulemaking procedures of the Administrative Procedure Act, 5 U.S.C. § 553 (1970). I add only this further thought. The panel opinion concedes, as it must, that rulemaking procedures are required if Rev. Rul. 69-545 has an "independent binding effect." If the Rev. Rul. were no more than "an opinion of the legal staff" of the Treasury,[1] I might agree with the majority that courts "are not bound by [the Revenue Ruling] unless they choose to accept it" and that, therefore, the Rev. Rul. has no independent binding effect. But in light of the traditional deference to Internal Revenue Service regulations in the interpretation of the more general sections of the Internal Revenue Code of 1954,[2] I think it a truly heroic assumption

[1] American President Lines, Ltd. v. Federal Maritime Comm'n, 316 F.2d 419, 422 (D.C. Cir. 1963). *See* Hou Ching Chow v. Attorney-General, 362 F. Supp. 1288, 1292 (D.D.C. 1973); Continental Oil Co. v. Burns, 317 F. Supp. 194 (D. Del. 1970). *Cf.* Pacific Gas & Elec. Co. v. FPC, Nos. 73-1358, -1485 (D.C. Cir. June 26, 1974) at 8-9 n.14, 10-13 (slip opinion); Lewis-Mota v. Secretary of Labor, 469 F.2d 478 (2d Cir. 1972); California Citizens Band Ass'n v. United States, 375 F.2d 43 (9th Cir.), *cert. denied*, 389 U.S. 844 (1967). There is nothing in Gibson Wine Co. v. Snyder, 194 F.2d 329 (D.C. Cir. 1952), which is inconsistent with these cases. There is, I think no one would doubt, a very substantial difference between regulations defining a type of grape and regulations interpreting such legislative phrases as "the public interest" or "tax avoidance purpose."

[2] *See* United States v. Cartwright, 411 U.S. 546, 550 (1973); Bingler v. Johnson, 394 U.S. 741, 749-51 (1969); Comm'r v. South Texas Lumber Co., 333 U.S. 496, 501 (1948); Comm'r v. O. Liquidating Co., 292 F.2d 225, 231 (3d Cir.), *cert. denied*, 368 U.S. 898 (1961); Kern v. Granquist, 291 F.2d 29, 32 (9th Cir. 1961). *Compare* Kurzner v. United States, 413 F.2d 97, 112 (5th Cir. 1969) *with* O'Neill v. United States, 410 F.2d 888 (6th Cir. 1969).

that courts will not be bound by the Ruling "unless they choose to accept it." Indeed, this tradition of deference informs the panel majority's own approach to the legality of Rev. Rul. 69-545. The majority does not review the issue *de novo* but instead concludes that the Ruling "is founded on a *permissible* definition of the term 'charitable' and is not contrary to any *express* Congressional intent."[3] If the majority were to review the issue *de novo*, it would, I take it, certainly want more information than is contained in the record before us here. And it is for expressly that reason, as Judge Wright so persuasively argues, that rulemaking hearings are required.[4] So the majority tells the plaintiffs that it will not be bound by the Internal Revenue Service interpretation of the term "charitable" and then turns right around and upholds the Service interpretation as a permissible exercise of discretion on the basis of factual assumptions which are not supported by a record and which plaintiffs have not had an opportunity to rebut. I will not concur in such reasoning.

[3] Slip op. at 23 (emphasis added).

[4] *See also* NLRB v. Wyman-Gordon Co., 394 U.S. 759, 775-80 (1969) (Douglas, J. dissenting).

Statement of *Circuit Judge* WRIGHT as to
Why He Voted to Grant Rehearing *En Banc*

Revenue Ruling 69-545, which the panel majority upholds, replaced Revenue Ruling 56-185 which provided that a hospital could qualify for tax exempt status only if it was "operated to the extent of its financial ability for those not able to pay for the services rendered and not exclusively for those who are able and expected to pay." Revenue Ruling 69-545 provides: "Revenue Ruling 56-185 is hereby modified to remove therefrom the requirements relating to caring for patients without charge or at rates below cost." Thus Revenue Ruling 69-545 worked a substantial change in the availability of hospital services for the poor. Yet, admittedly, neither the poor nor anyone else was given notice of the proposed change or allowed to comment on it.

On the basis of assumed social, economic, and technological changes in the need of the poor for free medical care, the panel majority approves Revenue Ruling 69-545. The record in this case does not reflect what the needs of the poor for free medical care really are because the Internal Revenue Service did not comply with the rule-making procedures required by Section 553 of the Administrative Procedure Act, 5 U.S.C. §553 (1970). Thus millions of poor people are effectively denied medical care without the procedural protections provided by law. If these procedural protections had been provided, doubtless it would have been disclosed that millions of Americans are indeed too poor to pay for hospital services and have no means of obtaining those services except as charity patients at our nonprofit hospitals. With this fact established as a matter of record, I confidently believe that Revenue Ruling 69-545 would never have been promulgated in the first place.

I would affirm the District Court in this case for the reasons stated in its opinion holding Revenue Ruling 69-545 invalid (*see Eastern Kentucky Welfare Rights*

Organization v. *Shultz*, D.D.C., 370 F. Supp. 325 (1973)). I would also hold Revenue Ruling 69-545 invalid because it was issued without compliance with the rule-making procedures required by Section 553 of the Administrative Procedure Act, 5 U.S.C. § 553, as indicated in my dissent to the panel opinion.

APPENDIX B

UNITED STATES COURT OF APPEALS
FOR THE DISTRICT OF COLUMBIA CIRCUIT

No. 74-1293 **SEPTEMBER TERM, 1974**

Civil Action 1378-71

EASTERN KENTUCKY WELFARE RIGHTS
ORGANIZATION, ET AL

v.

WILLIAM E. SIMON, ET AL
SECRETARY OF TREASURY
APPELLANTS

BEFORE: Wright and Wilkey, Circuit Judges;
Jameson*, U.S. Senior District Judge
for the District of Montana.

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ORDER

On consideration of appellees' petition for rehearing, it is

ORDERED by the Court that appellees' aforesaid petition is denied.

For the Court:

/s/ Hugh E. Kline
HUGH E. KLINE
Clerk

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* Sitting by designation pursuant to Title 28 U.S. Code Section 294(d).

Circuit Judge Wright would grant rehearing for the reasons set forth in his statement as to why he voted to grant rehearing *en banc*.

APPENDIX C

Notice: This opinion is subject to formal revision before publication in the Federal Reporter or U.S. App. D.C. Reports. Users are requested to notify the Clerk of any formal errors in order that corrections may be made before the bound volumes go to press.

UNITED STATES COURT OF APPEALS
FOR THE DISTRICT OF COLUMBIA CIRCUIT

No. 74-1293

EASTERN KENTUCKY WELFARE RIGHTS ORGANIZATION,
ET AL.

v.

WILLIAM E. SIMON, SECRETARY OF THE TREASURY, ET AL.,
APPELLANTS

Appeal from the United States District Court
for the District of Columbia
(D.C. Civil No. 1378-71)

Decided October 9, 1974

Wesley J. Filer, Attorney, Tax Division, Department of Justice, of the bar of the Supreme Court of Texas, *pro hac vice*, by special leave of court, with whom *Scott P. Crampton*, Assistant Attorney General, *Earl J. Silbert*, United States Attorney, and *Meyer Rothwacks* and *Leonard J. Henzke, Jr.*, Attorneys, Tax Division, Department of Justice, were on the brief, for appellants.

Marilyn G. Rose, with whom *Joseph Onek*, *Jeffrey B. Schwartz*, *Laurens H. Silver*, and *Anthony Z. Roisman* were on the brief, for appellees.

John A. Beck filed a brief on behalf of American Hospital Association as *amicus curiae* urging reversal.

Before WRIGHT and WILKEY, *Circuit Judges*, and JAMESON,* *Senior District Judge*.

Opinion for the court filed by *Senior District Judge* JAMESON.

Opinion concurring in part and dissenting in part filed by *Circuit Judge* WRIGHT.

JAMESON, *Senior District Judge:* Defendants-appellants, the Secretary of the Treasury and Commissioner of Internal Revenue, have appealed from an order granting summary judgment to plaintiffs-appellees and holding that "private nonprofit hospitals seeking tax exempt status as charitable organizations under § 501 (c)(3) of the [Internal Revenue] Code must provide free or below cost treatment to individuals unable to pay for such services" and that a revenue ruling modifying this requirement is void.[1]

I. BACKGROUND

Sections 501 (a) and (c) (3) of the Internal Revenue Code of 1954 (26 U.S.C. 501(a) and (c)(3)) exempt from federal income tax: "(3) Corporations, and any community chest, fund, or foundation, organized and operated exclusively for charitable . . . purposes, . . . no part of the net earnings of which inures to the benefit of any private shareholder or individual . . .". Other related sections of the Code provide that contributions to such tax exempt charitable organizations are deductible for purposes of computing federal income tax (26 U.S.C. § 170) and estate and gift taxes (26 U.S.C. §§ 2055 (a)(2), 2106 (a) (2) (A) (ii) and 2522 (a) (2)).

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* Of the United States District Court for the District of Montana, sitting by designation pursuant to 28 U.S.C. § 294 (d) (1970).

[1] By order of this court, the American Hospital Association was granted leave to file briefs as *amicus curiae*.

Hospitals and other health organizations have never been expressly categorized as tax exempt organizations and have achieved that status only by qualifying as "charitable" organizations under the Code. Long established Internal Revenue Service (I.R.S.) policy held that hospitals qualified as charitable organizations under 501 (c) (3) only if they provided free or below cost service to those unable to pay. This policy was articulated in Revenue Ruling 56-185, which held that a hospital could qualify for tax exempt status only if it was "operated to the extent of its financial ability for those not able to pay for the services rendered and not exclusively for those who are able and expected to pay".[2]

The I.R.S. modified this position in 1969 with the issuance of Revenue Ruling 69-545. The new ruling broadly defines "charitable" in terms of community benefit and holds that the promotion of health constitutes a "charitable purpose" in the "generally accepted legal sense of that term"[3] and within the meaning of §501(c)(3) of the Code. According to the ruling,

> "The promotion of health . . . is one of the purposes in the general law of charity that is deemed beneficial to the community as a whole even though the class of beneficiaries

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[2] Other pertinent parts of Revenue Ruling 56-185 state: "It is normal for hospitals to charge those able to pay for services rendered in order to meet the operating expenses of the institution without denying medical care or treatment to others unable to pay. . . It may furnish services at reduced rates which are below cost, and thereby render charity in that manner. . . . It must not, however, refuse to accept patients in need of hospital care who cannot pay for such services."

[3] As a basis for its conclusion that in the "general law of charity" the promotion of health is a charitable purpose, the I.R.S. relies on RESTATEMENT (SECOND) TRUSTS, sec. 368 and 372, and IV SCOTT ON TRUSTS (3rd.ed. 1967) sec. 368 and 372.

> eligible to receive a direct benefit from its activities does not include all members of the community, such as indigent members of the community . . .".

Based on this community benefit concept, a nonprofit hospital can quality as a charitable organization under 501(a)(3) "By operating an emergency room open to all persons and by providing hospital care for all those persons in the community able to pay the cost thereof either directly or through third party reimbursement . . ." [e.g. private health insurance, Medicare, or Medicaid]. Thus, for a hospital to qualify as a tax exempt organization, the provision of free or below cost service to those unable to pay is no longer essential.[4]

Alleging harm from this new ruling, the plaintiffs-appellees, a group of health and welfare organizations and indigent persons, brought this action seeking to declare Revenue Ruling 69-545 invalid and to enjoin its implementation. They submitted affidavits recounting incidents in various parts of the country involving the denial of hospital services to indigents by institutions enjoying tax exempt status as "charitable" organizations.

Plaintiffs contended that (1) the Revenue Ruling constitutes an improper administrative alteration of the Internal Revenue Code in contradiction of long-standing Congressional tax policy and judicial interpretation; (2) the Ruling was not properly adopted due to the I.R.S. failure to grant interested parties an opportunity to be heard, allegedly a violation of the Administrative Procedure Act and the Fifth Amendment right of due process; and (3) the Ruling was an "abuse of discretion".

The defendants moved for dismissal of plaintiffs' complaint on the ground that the court lacked jurisdiction to

[4] Revenue Ruling 69-545 expressly states: "Revenue Ruling 56-185 is hereby modified to remove therefrom the requirements relating to caring for patients without charge or at rates below cost".

entertain the action. The court denied this motion without opinion. Subsequently, upon the parties' cross motions for summary judgment, the court granted summary judgment in favor of the plaintiffs.

The court held:

(1) The plaintiffs have standing to maintain this action because they "have demonstrated sufficient injury flowing from the issuance of Revenue Ruling 69-545" and fall within the zone of interests protected by the Code.[5]

(2) The Federal tax exemption to the Declaratory Judgement Act, 28 U.S.C. § 2201, and the Tax Injunction Act, 26 U.S.C. § 7421 (a), do not bar the suit.

(3) Judicial review of the Revenue Ruling is not precluded by the Administrative Procedure Act's provision in 5 U.S.C. § 701 (a) (2) which forbids review of "agency action . . . committed to the agency discretion by law".

(4) The new Revenue Ruling does not comport with Congressional intent but rather is clearly contrary to the relevant judicial, legislative and administrative history on the matter. In light of this, the "community benefit" theory cannot "justify the basic shift in policy". The promulgation of the new ruling was therefore unauthorized.

Contentions on Appeal

Appellants level a dual attack against the judgement. First, they contend that the district court lacked jurisdiction in that the action is barred by (a) sovereign immunity, (b) the Anti-Injunction Act and the tax exemption to the Declaratory Judgment Act, and (c) the Administrative

[5] The district court, with respect to standing, noted that generally an action challenging a ruling of the Internal Revenue Service is in the nature of a refund action. The ruling challenged in this instance, however, is not one that will produce protesting taxpayers. The court concluded that this should not "immunize the Ruling" from judicial scrutiny, especially where, as here, the plaintiffs belong to a class of people whom the relevant sections of the Code purport to benefit.

Procedure Act.[6] Second, appellants argue that Revenue Ruling 69-545 was authorized and does meet the charitable standard of § 501 (c) (3) of the Code. In addition to opposing the contentions of appellants, appellees argue that the Revenue Ruling was not promulgated in accordance with the notice and hearing requirement of the Administrative Procedure Act and constitutes an abuse of discretion.

II. JURISDICTION

(a) *Sovereign Immunity*

The defense of sovereign immunity is jurisdictional. *See United States* v. *Sherwood*, 312 U.S. 584, 61 S.Ct. 767, 85 L.Ed. 1058 (1941). Generally, without specific authority, a court may not entertain an action against the sovereign. That doctrine, however, is not without its exceptions. The two primary exceptions were delineated in *Larson* v. *Domestic and Foreign Corp.*, 337 U.S. 682, 69 S.Ct. 1457, 93 L.Ed. 1628 (1949): sovereign immunity will not serve to bar jurisdiction when (1) the actions of a government official are beyond the scope of his authority or (2) "the statute or order conferring power upon the officer to take action in the sovereign's name is claimed to be unconstitutional". *Id.* at 689-690; *accord Dugan* v. *Rank*, 372

[6] The American Hospital Association in its *amicus* brief and appellants in note 46 of their brief contend also that appellees do not have standing because they have failed to demonstrate injury by an agency to an interest protected by the Code. This issue was discussed at length in the opinion of the district court. We agree with the court's conclusion that appellees made a sufficient showing of "injury in fact" to an interest "arguably within the zone of interests to be protected or regulated". *See, Sierra Club* v. *Morton*, 405 U.S. 727, 733, 92 S.Ct. 1361, 31 L.Ed.2d 636 (1972); *United States* v. *Students Challenging Regulatory Agency Procedures*, 412 U.S. 669, 93 S.Ct. 2405, 37 L.Ed.2d 254 (1973).

U.S. 609, 621-622, 83 S.Ct. 999, 10 L.Ed.2d 15 (1963). Here plaintiffs alleged, and the district court found, that government officials had acted beyond their statutory power.

Appellants contend that (1) regardless of exceptions that may have been formulated in other judicial areas, sovereign immunity in matters of federal tax remains an absolute bar; (2) even if the *Larson* exceptions are viable in tax cases, the Commissioner was authorized by statute to interpret the term "charitable" as he did; and (3) mere error by the Commissioner in his interpretation of "charitable" would not negate the application of sovereign immunity, *Larson*, *supra* at 690.

Appellants rely on *Louisiana* v. *McAdoo*, 234 U.S. 627, 34 S.Ct. 938, 58 L.Ed. 1506 (1914) in support of their contention that the defense of sovereign immunity is absolute with respect to the area of federal taxes. *McAdoo* involved an action against the Secretary of the Treasury brought by the State of Louisiana as a sugar producer. Louisiana challenged the Secretary's determination of the tariff rates to be applied to sugar imported from Cuba. The Court held that the defense of sovereign immunity barred the action regardless of the fact that the State of Louisiana claimed that the action of the Secretary was not authorized by law.

McAdoo, however, must be viewed in its proper perspective. The Court decided that case in 1914. Since then, significant changes have occurred in the area of standing, and exceptions to the doctrine of sovereign immunity have been judicially recognized. *Larson* and *Dugan*, *supra*. Moreover, with the advent of the Administrative Procedure Act in 1946, the continued viability of sovereign immunity with respect to administrative actions has been seriously questioned. *Scanwell Laboratories, Inc.* v. *Shaffer*, 424 F.2d 859, 873 (D.C. Cir. 1970).

The exceptions to the doctrine of sovereign immunity set forth in *Larson* have been applied in federal tax cases. In *McGlotten* v. *Connally*, 338 F.Supp. 448 (D. D.C. 1972), a

nontaxpayer challenged the exempt status of a fraternal organization with racially discriminatory memebership policies. The three-judge court rejected a sovereign immunity argument, holding that the "action falls readily within the two long-standing exceptions to that doctrine". *Id.* at 454, n. 27.[7] This court recognized the application of those exceptions in *Americans United* v. *Walters*, 477 F.2d 1169 (1973), reversed on other grounds *sub nom. Alexander* v. *Americans United*, _____ U.S. _____, 94 S.Ct. 2053 (1974).[8]

The Government is correct in contending that "a claim of error" in the exercise of an officer's powers is not sufficient to invoke the scope of authority exception to the sovereign immunity doctrine. *Larson, supra* at 690. Plaintiffs in this case, while not challenging the fact that the Secretary or Commissioner has the authority to prescribe rules and regulations for the administration of the revenue laws, nevertheless do challenge the authority of the Commissioner to interpret a revenue statute in a manner contrary to long-established Congressional policy. Thus, more than mere error on the part of the Commissioner is alleged. The court, therefore, has jurisdiction to determine whether or not the action of the Commissioner was authorized. The court has jurisdiction to determine its jurisdiction, *Land* v. *Dollar*, U.S. 731, 739 (1947), even though such a determination requires a decision on the merits. *Larson, supra* at

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[7] The Government argues that *McGlotten* is either wrong or distinguishable in that it involved racial discrimination, a judicially sensitive issue. That the racial aspect was the controlling factor in the court's determination of *McGlotten* is not supported by the language of the decision.

[8] See also *Green* v. *Kennedy*, 309 F.Supp. 1127 (D. D.C. 1970), continued *sub nom. Green* v. *Connally*, 330 F.Supp. 1150 (D. D.C. 1971), *aff'd per curiam sub nom. Coit v. Green*, 404 U.S. 997, 92 S.Ct. 564, 30 L.Ed.2d 550 (1971); *Junior Chamber of Commerce of Rochester, Inc.* v. *The United States Jaycees*, 495 F.2d 883 (10 Cir. 1974).

690; *Bell* v. *Hood*, 327 U.S. 678, 682-683, 66 S.Ct. 773, 90 L.Ed 939 (1946); *Junior Chamber of Commerce, supra.*

That sovereign immunity does not serve as a bar to the present action is further established by this court's position that the Administrative Procedure Act constitutes a waiver of sovereign immunity. Quoting from *Estrada* v. *Ahrens*, 296 F.2d 690, 698 (5 Cir. 1961) this court in *Scanwell, supra* at 873 stated:

> "By providing judicial review in an action brought by 'any person adversely affected or aggrieved by any agency action' Congress permitted suits which under established tests would certainly be barred as suits against the government . . . . The Act thereby makes a clear waiver of sovereign immunity in actions to which it applies."

We conclude that the district court correctly held that the action was not barred by the doctrine of sovereign immunity.

(b) *Anti-Injunction and Declaratory Judgement Acts*

The Anti-Injunction Act (26 U.S.C. § 7421 (a)) provides in relevant part: ". . . no suit for the purpose of restraining the assessment or collection of any tax shall be maintained in any court by any person, whether or not such person is the person against whom such tax was assessed". In *Bob Jones University* v. *Simon*, _____ U.S. _____, 94 S.Ct. 2038, 2046 (1974), the Court stated:

> "The Court has interpreted the principal purpose of this language to be the protection of the Government's need to assess and collect taxes as expeditiously as possible with a minimum of pre-enforcement judicial interference, 'and to require that the legal right to the disputed funds to be determined in suit for a refund.' *Enochs* v. *Williams*

Packing and Navigation Co., 370 U.S. 1, 7, 82 S.Ct. 1125, 1129, 8 L.Ed.2d 292 (1962)."

Here, the plaintiffs as nontaxpayers seek to have the I.R.S. enjoined from granting tax exempt status to hospitals which fail to provide free or reduced-charge services to indigents. The case of *McGlotten* v. *Connally*, *supra* is analogous. In *McGlotten* a black American brought a class action "to enjoin the Secretary of the Treasury from granting tax benefits to fraternal and nonprofity organizations which exclude non-whites from membership". *Id.* at 450. In rejecting the contention that the Anti-Injunction Act barred the suit, the court concluded that the action had "nothing to do with the assessment or collection of taxes. He [the plaintiff] does not contest the amount of his own tax, nor does he seek to limit the amount of tax revenue collectible by the United States. The preferred course of raising his objections in a suit for a refund is not available. In this situation we cannot read the statute to bar the present suit." *Id.* at 453-454.

The *McGlotten* rationale was followed by this court in *Americans United* v. *Walters*, 477 F.2d 1169 (1973) in holding that a corporation in challenging the revocation of its tax exempt status was not attempting to restrain the assessment or collection of taxes. The Supreme Court, however, in *Alexander* v. *Americans United, Inc.*, ____ U.S. ____, 94 S.Ct. 2053 (1974) reversed. The Court held that the purpose of the suit was to restrain the collection of taxes from contributors to the corporation. Accordingly, the Anti-Injunction Act applied and barred the action. The Court further stressed that an adequate legal remedy existed in the form of refund litigation.

Americans United, however, did not involve the factual situation presented in *McGlotten* and in this action. Here, as in *McGlotten*, rather than attempting to negate the levy of a tax, the plaintiffs are seeking to force the Government to impose a tax on contributions to certain hospitals. This, therefore, is not a case wherein the Government is faced

with any threat to the actual assessment or collection of the taxes to which it deems itself entitled.

In addition, there is merit in the claim that there is not other adequate legal remedy.[9] Obviously neither the tax exempt charitable hospitals nor their contributors will institute refund litigation, as the contributions are tax free. It is apparent from a close analysis of the Anti-Injunction Act that it did not contemplate barring actions, such as this, where the litigation did not threaten to deny anticipated tax revenues to the Government.

Appellants next contend that, even if the Anti-Injunction Act is held inapplicable, the tax exemption provision of the Declaratory Judgment Act (28 U.S.C. § 2261) bars the action. That provision authorizes federal courts to grant declaratory judgments "except with respect to Federal taxes". Appellants argue that the Declaratory Judgment Act is much broader in scope than the Anti-Injunction Act.

In *McGlotten*, *supra*, the court concluded that the Anti-Injunction Act and Declaratory Judgment Act are coterminous. The court in *Americans United*, *supra*, following the rationale of *McGlotten*, held that while the tax exemption provision of the Declaratory Judgment Act is literally broader than the Anti-Injunction Act provision, nevertheless the two are coterminous. The court reasoned that it would be paradoxial to authorize injunctive relief in some cases "while depriving courts the authority to declare the rights of the parties in connection with the injunctive relief". *Id.* at 1176.

Although the Supreme Court reversed *Americans United*, it did not deal with the issue of whether or not the Declaratory Judgement Act was broader than the Anti-

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[9] In *Bob Jones*, *supra* at 2050, the Court stated: "This is not a case in which an aggrieved party has no access at all to judicial review. Were that true, our conclusion might well be different."

Injunction Act.[10] A re-examination of the legislative history of the tax exemption provision leads this court to conclude, as it did in *Americans United*, that the Declaratory Judgment Act and the Anti-Injunction Act were intended to be coterminous.[11] Therefore, just as the Anti-Injunction Act does not bar this action, neither does the Declaratory Judgment Act.

(c) *Administrative Procedure Act*

In contending that the Administrative Procedure Act precludes this action, appellants rely on 5 U.S.C. 701 (a) (1), which indicates that administrative actions are not subject to review "to the extent that statutes preclude judicial review". With respect to this exception, the Supreme Court

[10] With respect to the question of whether the Declaratory Judgment Act is coterminous with the Anti-Injunction Act, the Court stated: "While we take no position on this issue, it is in any event clear that the federal tax exception to the Declaratory Judgment Act is at least as broad as the prohibition of the Anti-Injunction Act". 94 S.Ct. at 2057-2058, n. 10.

[11] When the Declaratory Judgment Act was passed in 1934, the Act did not contain the phrase "except with respect to Federal taxes", which now appears in § 2201. Some taxpayers used the Declaratory Judgement Act to do what they were prohibited from doing under the Anti-Injunction Act. *See, e.g. Penn* v. *Glenn*, 10 F.Supp. 483 (W.D. Ky. 1935), *app. dismissed per curiam*, 84 F.2d 1001 (6 Cir. 1936), and *F.G. Vogt and Sons, Inc.* v. *Rothensies*, 11 F.Supp. 225 (E.D. Pa. 1935). Congress reacted to this by amending the Declaratory Judgment Act to include the tax exemption provision (Act of August 30, 1935, Ch. 829, § 405, 49 Stat. 1027). As noted by this court in *Americans United, supra* at 1176:

"The Senate Finance Committee, in reporting out the amended version, stated that the 'application of the Declaratory Judgments Act to taxes would constitute a radical departure from the long-continued policy of Congress [as represented today by § 7421 (a)] with respect to the determination, assessment, and collection of Federal taxes.'"

With this legislative history it appears clear that Congress intended the Declaratory Judgment Act § 2201 to be coterminous with the Anti-Injunction Act.

has held that access to judicial review will generally not be denied unless there is a showing by "clear and convincing evidence" of a contrary legislative intent. *Rusk* v. *Cort*, 369 U.S. 367, 379-380 (1962). Appellants argue that the Anti-Injunction Act, the tax exception to the Declaratory Judgment Act and the doctrine of sovereign immunity, combined with specific procedures established by Congress for review of tax matters, all indicate Congressional intent to "preclude judicial review".

We have concluded, however, that the Anti-Injunction Act, Declaratory Judgment Act and sovereign immunity do not bar this action. It is of course true, as appellants contend, that Congress has prescribed procedures for challenging administrative determinations of tax liability. Those procedures, however, are applicable only to cases involving the imposition of a tax, whereas here the challenge is made to a determination that certain hospitals are exempt from taxation as charitable organizations. We find no "clear and convincing evidence" that Congress intended to preclude judicial review in a case such as this.[12]

If anything, the pertinent Congressional enactments indicate a Congressional intent that the actions of the In-

[12] Appellants rely heavily on *National Railroad Passenger Corp.* v. *National Assn. of Railroad Passengers* ____ U.S. ____, 94 S.Ct. 690 (1974). That case involved the question of whether an organization representing railroad passengers could bring an action to enjoin the discontinuance of certain passenger trains operated by the National Railroad Passengers Corporation (Amtrak). The Court concluded that the private citizens had no right to bring the injunctive action. The case, however, is not in point. There is a significant difference between forcing the Government to incur deficits by requring the continuance of train service and forcing the Government to tax contributions to certain hospitals. Furthermore, in *National Railroad* the legislative history of Amtrak Act indicated a Congressional intent to preclude private causes of action. *Id.* at 694. No such Congressional intent is to be found with respect to the Internal Revenue Code. Finally, Congress in the Amtrak Act expressly provided that the Attorney General should have the right to secure judicial review. Here no judicial review is possible except in an action by the plaintiffs.

ternal Revenue Service be subject to judicial review. The provision for review of the "assessment and collection" of taxes by the I.R.S. are the basis for many hundreds of taxpayer and I.R.S. suits every year. By means of refund and deficiency actions, the courts review the policies, practices, rulings, interpretations and actions of the Internal Revenue Service. Those cases cannot be commenced until after the assessment and collection of taxes. As noted *supra*, the rationale limiting suits to the post-collection period is not applicable in this case. To limit plaintiffs to a refund action under these facts is, as the district court concluded, equivalent to denying them judicial relief. That result is without foundation in the relevant law.

III. VALIDITY OF REVENUE RULING 69-545

In holding that "Revenue Ruling 69-545 was improperly promulgated and is without effect", the district court concluded that "based on relevant judicial, legislative, and administrative decisions" the new Ruling constituted an unauthorized reversal of a long-established policy of requiring exempt hospitals "to offer special financial consideration to persons unable to pay". The court recognized that "as a matter of jurisdiction and efficient tax administration . . . courts have regularly paid deference to the expertise attributed to the I.R.S. in tax related matters and therefore judicial interference has been reluctantly employed". The court continued: "However, this exhibition of restraint is predicated upon the assumption that administrative rulings will do no more than effectuate, implement and clarify the provisions of the Code which have been Congressionally enacted. . . . When this assumption is proven wrong, the courts must act to rectify any administrative determination which is not in accord with the Code."

We do not disagree with these principles of judicial interpretation of administrative rulings, but our own analysis

of the judicial, legislative, and administrative decisions leads to a contrary result. We conclude the Revenue Ruling 69-545 is not inconsistent with 26 U.S.C. § 501 (c) (3) and that the modification of the prior ruling was authorized.

The definition of the term "charitable" has never been static and has been broadened in recent years. Prior to 1959, Treasury Regulations generally defined charitable organizations as those operated for the relief of the poor.[13] In 1959, however, a comprehensive set of regulations interpreting § 501(c)(3) was issued.[14] These regulations adopted a broad concept of "charitable". The key provision, § 1.501(c)(3)-1(d)(2) reads:

> "(2) *Charitable defined.* The term 'charitable' is used in section 501 (c((3) in its generally accepted legal sense and is, therefore, not to be construed as limited by the separate enumeration in section 501 (c) (3) of other tax exempt purposes which may fall within the borad outlines of 'charity' as developed by judicial decisions. Such term includes: Relief of the poor and distressed or of the underprivileged; advancement of

[13] *See*, e.g. Treas. Reg. § 39.101 (b)-1 (b) (1939 Code) which stated:

"Corporations organized and operated exclusively for charitable purposes comprise, in general, organizations for the relief of the poor."

See also, I.T. 1800, II-2 Cum. Bull. 152 (1923), a ruling of the Commissioner of the I.R.S., which held that the term "charitable" in the predecessor of Section 501 (c) (3) was used in its more restrictive sense of relief of the poor, rather than its broader legal sense in the law of charities.

[14] Revenue Ruling 56-185 was issued in 1956. Proposed regulations were also initially issued in 1956, repeating the restrictive view of charity contained in Ruling 56-185. (21 Fed. Reg. 460, 464 Jan. 21, 1956). These were withdrawn for more extensive study. The comprehensive set of regulations was proposed early in 1959 (24 Fed. Reg. 1421, 1423 Feb. 26, 1959) and, after public hearings, final regulations were issued, T.D. 6391, (24 Fed. Reg. 5217, 5219 June 26, 1959).

religion; advancement of education or science; erection or maintenance of public buildings, monuments, or works; lessening of the burdens of Government; and promotion of social welfare by organiztions designed to accomplish any of the above purposes, or (i) to lessen neighborhood tensions; (ii) to eliminate prejudice and discrimination; (iii) to defend human rights secured by law; or (iv) to combat community deterioration and juvenile delinquency."

This Treasury Regulation was cited in *Green* v. *Connally, supra,* wherein the three-judge district court stated with respect to § 501 (c) (3):

> ". . . clearly, the term 'charitable' is used 'in its generally accepted legal sense,' Treas. Reg. § 1.501 (c) (3)-1(d) (2), and not in a street or popular sense (such as, e.g., *benevolence to the poor and suffering*). *See* H. Reiling, 'What is a Charitable Organization?. 44 A.B.A.J. 525, 527 (1958). Thus, 'strong analogy' can be derived from the general common law of charitable trusts, at least for close interpretative questions." 330 F.Supp. at 1157. (emphasis added).[15]

In promulgating Revenue Ruling 69-545, the Commissioner did rely on an analogy to the law of charitable trusts. As indicated earlier, the Commisioner cited both the RESTATEMENT (SECOND) OF TRUSTS (3rd ed. 1967) sec.

[15] The court said in part: "Changes in the courts' conceptions of what is charitable are wrought by changes in moral and ethical precepts generally held, or by changes in relative values assigned to different and sometimes competing and even conflicting interests of society." *Id.* at 1159.

368 and sec. 372[16] in holding that the promotion of health is a charitable purpose within the meanIng of § 501(c) (3).

The term "charitable" is thus capable of a definition far broader than merely the relief of the poor. The law of charitable trusts supports the borader concept. The question involved here then is whether the term "charitable" as used in § 501 (c) (3) may be broadly interpreted as was done in Revenue Ruling 69-545 or is to be restricted to its narrow sense of relief of the poor.

We cannot conclude, as did the district court, that Congress intended the latter construction. While it is true that in the past Congress and the federal courts have conditioned a hospital's charitable status on the level of free or below cost care that it provided for indigents,[18] there is no authority for the conclusion that the determination of

[16] The RESTATEMENT (SECOND) OF TRUSTS sec. 368 (1959) states:

"Charitable purposes include:

(a) the relief of proverty;
(b) the advancement of education;
(c) the advancement of religion;
(d) *the promotion of health;*
(e) governmental or municipal purposes;

(f) other purposes the accomplishment of which is beneficial to the community." (emphasis added).

[17] SCOTT ON TRUSTS, 3rd.Ed. sec. 368, p. 2853 states "It is well settled that the promotion of health is a charitable purpose". Later in his treatise, Professor Scott observed that "a trust for the promotion of health, however, is nonetheless charitable although the benefits are not limited to the poor". Scott, *op. cit.* sec. 372, p. 2895.

[18] *Commissioner* v. *Battle Creek, Inc.*, 126 F.2d 405 (5 Cir. 1972); *Davis Hospital, Inc.*, 4 CCH Tax. Ct. Memo. 312 (1945); *Inter-City Hospital Association v.* Squire, 56 F.Supp. 472 (W.D. Wash. 1944)' *Goldsby King Memorial,* 3 CCH Tax. Ct. Memo. 693 (1944); *Lorain Avenue Clinic,* 31 T.C. 141 (1958); *Robert C. Olney,* 17 CCH Tax Ct. Mem. 982 (1958); *Sonora Community Hospital,* 46 T.C. 519 (1966), *aff'd per curiam,* 397 F.2d 814 (9 Cir. 1968).

"charitable" status was always to be so limited. Such an inflexible construction fails to recognize the changing economic, social and technological precepts and values of contemporary society.

In the field of health care, the changes have been dramatic. Hospitals in the early part of this nation's history were almshouses supported by philanthropy and serving almost exclusively the sick poor.[19] Today, hospitals are the primary community health facility for both rich and poor. Philanthropy accounts for only a minute percentage of the hospital's total operating costs.[20] Those costs have soared in recent years as constant modernization of equipment and facilities is necessitated by the advances in medical science and technology.[21] The institution of Medicare and

[19] As noted by one commentator:

"General hospitals were established in the United States as early as the 18th century to serve the sick, poor and offer a roof and bed for the homeless or for those whose homes were inadequate. These institutions were primarily the last resort of the sick. Their standards of care did not approach those for the simplest custodial care today." John H. Hayes, ed., *Financing Hospital Care in the United States*, Vol. I. "Factors Affecting the Cost of Hospital Care" (1954), p. 9.

[20] Professor William Thomas speaking before a special Senate subcommittee in 1965 stated:

"The image of a voluntary institution as a charitable organization, financing its care of patients to a substantial degree through philanthropy . . . is largely anachronistic. Philanthropy, through increasing, has not been able to match the redoubled demands for health care." *Hearings on Conditions and Problems of the Nation's Nursing Homes*. Subcommittee on Long Term Care, Spec. Committee on Aging, U.S. Senate, 89th Cong., 1st Sess., Pt. 2 (Feb. 15, 1965), p. 559.

[21] "Hospital expenses per patient day have increased over 700% since 1946, rising especially rapidly the last several years. . . . Among factors contributing to the rise in hospital expense are technological changes, increased demand, and rising costs of labor and supplies. . . . The public also demands more—a large number of more costly services—from the hospital now than it did two decades ago because of rising income, increasing insurance coverage, and changing demongraphic charactersitics of the population." *Basic Facts on the Health Industry*. Committee on Ways and Means, 91st Cong., 1st Sess., June 28, 1971, p. 52.

Medicaid in the last decade combined with the rapid growth of medical and hospital insurance has greatly reduced the number of poor people requiring free or below cost hospital services. Much of that decrease has been realized since the promulgation of Revenue Ruling 56-185. Moreover, increasingly counties and other political subdivisions are providing nonemergency hospitalization and medical care for those unable to pay.[22] Thus, it appears that the rationale upon which the limited definition of "charitable" was predicated has largely disappeared.[23] To continue to base the "charitable" status of a hospital strictly on the relief it provides for the poor fails to account for these major changes in the area of health care.

[22] The Supreme Court, in holding unconstitutional a state statute requiring a year's residence in a county as a condition to an indigent receiving nonemergency hospitalization or medical care at the county's expense, referred to the "astronomical costs of hospitalization which bear so heavily on the resources of most Americans" and the fact that the "financial pressures under which private nonprofit hospitals operate have already led many of them to turn away patients who cannot pay or to severely limit the number of indigents they will admit". *Memorial Hospital* v. *Maricopa County*, 415 U.S. 250, 265 (1974).

[23] The state courts have recognized these changes in the health care field. As stated by the Supreme Court of Nebraska in *Evangelical Lutheran Good Samaritan Society* v. *County of Gage*, 181 Neb. 831, 151 N.W.2d 446, 449 (1967):

> "Formerly all institutions furnishing services of this nature, including hospitals and nursing homes, were providing care for many patients without compensation and extended charity in the sense of alms-giving or free services to the poor. With the advent of present day social security and welfare programs, this type of charity is not often found because assistance is available to the poor under these programs. Yet, *** the courts have defined 'charity' to be something more than mere alms-giving or the relief of poverty and distress, and have given it a significance broad enough to include practical enterprises for the good of humanity operated at a moderate cost to those who receive the benefits."

In holding Revenue Ruling 69-545 void, the district court placed undue emphasis on the fact that Congress in 1969 failed to amend the Internal Revenue Code by including language which would have conformed the Code to the new ruling. The Senate Finance Committee in deleting a House provision which would have allowed exempt status to institutions "organized and operated exclusively for the proviind of hospital care" stated:

> "The committee deleted from the bill those provisions which would have conformed the code to the result reached by the 1969 ruling. The committee decided to reexamine this matter in connection with pending legislation on Medicare and Medicaid." [24]

This action or inaction by Congress cannot be interpreted as disapproving the new ruling. Congress could have rejected the ruling had it determined that it was not in conformity with the Code. Instead, it committed the matter for further study in the light of Medicare and Medicaid. No further action has been taken by Congress since the ruling became effective in 1969.

It is important to note also that Revenue Ruling 69-545 rather than overruling Revenue Ruling 56-185 simply provides an alternative method whereby a nonprofit hospital can qualify as a tax exempt charitable organization. That method entails the operation of an emergency room open to all regardless of their ability to pay and providing hospital services to those able to pay the cost either directly or through third party reimbursement. Thus,

[24] Actually the provision of the House bill which was deleted provided a broader exemption than Revenue Ruling 69-545. It would have afforded exempt status to all nonprofit hospitals. Ruling 69-545 requires the operation of an emergency room open to all regardless of ability to pay as well as acceptance of Medicare and Medicaid patients and patients whose hospital costs will be paid by third parties.

to qualify as a tax exempt charitable organization, a hospital must still provide services to indigents.

The required provision of emergency room services is of great import to the indigent. Emergency room service is often the only means of access that the poor have to medical care.[25] Furthermore, the fact that hospitals seeking to qualify as charities pursuant to Revenue Ruling 69-545 must accept Medicare and Medicaid patients is also significant. A large percentage of the indigent populace of the nation is now covered by either Medicare or Medicaid. In the final analysis, Revenue Ruling 69-545 may be of greater benefit to the poor than its predecessor Ruling 56-185.[26] Certainly Ruling 69-545 is more in conformity with the concept of "charitable" as defined in the Treasury Regulation adopted, after extensive study, in 1959 and interpreting § 501 (c) (3).

[25] Finding a physician and getting health care is particularly difficult for families who change communities. A significant portion of these are poor. When health needs become critical, families that do not have adequate financial resources may find the emergency rooms and outpatient clinics of general hospitals the only available resource. These families, along with poor families, who often have no other alternative, have contributed to the 150 million emergency room and outpatient visits in 1967, an increase of 250% during the past two decades." *National Advisory Commission on Health Facilities: A Report of the President* (1969), p. 20.

[26] Moreover, Revenue Ruling 69-545 sets forth a more definite and specific standard. Under Revenue Ruling 56-185 hospitals were required to provide free care only to the extent of their financial ability. Hospitals operating at a deficit would have no obligation under Ruling 56-185. In addition the Ruling qualified the "financial ability" standard by providing:

"The fact that its charity record is relatively low is not conclusive that a hospital is not operated for charitable purposes to the full extent of its financial ability . . . . It may also set aside earnings which it uses for improvements and additions to hospital facilities. . . . A nominal charity record for a given period of time, in the absence of charitable demands of the community, will not affect its right to continued exemption."

In summary, we conclude that Revenue Ruling 69-545 is founded on a permissible definition of the term "charitable" and is not contrary to any express Congressional intent.

IV. NOTICE AND HEARING REQUIREMENTS OF APA; ABUSE AND DISCRETION

Appellees contend that, if this court should find that the Commissioner was authorized to promulgate Revenue Ruling 69-545, the district court must nevertheless be sustained because appellants had the legal obligation under 5 U.S.C. § 553 to afford appellees an opportunity to be heard.[27] They argue that Revenue Ruling 69-545 is a substantive rule as opposed to an interpretative ruling and therefore § 553 of the APA is applicable.

Section 553 of the Administrative Procedure Act expressly excepts interpretative rules from the notice and hearing requirements of the Act. This court distinguished interpretative and substantive rules in *Gibson Wine Co.* v. *Snyder*, 194 F.2d 329 (1952):

> "Generally speaking, it seems to be established that 'regulations', 'substantive rules' or 'legislative rules' are those which create law, usually implementary to an existing law; whereas interpretative rules are statements as to what the administrative officer thinks the statute or regulation means. . . . 'A substantive rule is one which . . . is intended to implement the statutory structure or the statutory powers of any agency. An interpretative rule is one which does not have

[27] Having determined that the Revenue Ruling conflicted with Congressional intent, the district court did not reach appellees' contentions that the Ruling was promulgated without proper notice and hearing and constituted an abuse of discretion.

> the full force and effect of a substantive rule but which is in the form of an explanation of particular terms in an Act. If you had an expression in a statute such as 'Interurban Railway,' the query might come up as to what is an 'interurban railway'. A particular agency may adopt a rule defining an interurban railway. That, in a sense, may be called an interpretative rule.' " *Id.* at 331-332.[28]

Here the Commissioner interpreted the meaning of the term "charitable" in § 501 (c) (3). The fact that the term had been interpreted by the Commissioner differently in an earlier revenue ruling is not controlling. In the meantime Treasury Regulations containing a broader concept of "charitable" had been adopted in 1959, after notice and public hearings. In our opinion Internal Revenue 69-545 conforms to the definition of "charitable" set forth in these Regulations. Furthermore, appellants concede that Revenue Ruling 69-545 has no independent binding effect and that the courts are not bound by it unless they choose to accept it as a proper interpretation of the meaning of the word "charitable" as used in § 501 (c) (3).[29] We conclude that Revenue Ruling 69-545 is an interpretative ruling and is not subject to the requirements of § 553 of the APA.[30]

[28] *Accord, United States* v. *353 Cases, etc.*, 247 F.2d 473, 480 (8 Cir. 1957).

[29] *See, American President Lines, Ltd.* v. *Federal Maritime Commission*, 316 F.2d 419, 421-422 and n. 5 (D.C. Cir. 1963).

[30] Appellees lay great stress on the facts that (1) Revenue Ruling 69-545 has a substantial impact on the availability of hospital services for the poor; (2) the I.R.S. is not an expert in health care delivery problems and thus needs to be educated; and (3) the Ruling constitutes a reversal of longstanding I.R.S. policy. While these factors have been considered by the courts with respect to whether notice and hearing are required by the APA, they are not determinative here where a ruling is clearly interpretative in nature and has no legally binding effect.

Appellees finally contend that the promulgation of Revenue Ruling 69-545 constituted an abuse of discretion and should be set aside pursuant to U.S.C. 706(2)(A.)[1] Appellees argue that the Internal Revenue Service acted without considering all of the relevant factors. Their primary attack is again levelled at an alleged failure of the I.R.S. to consider the needs of the poor.

We cannot agree. On its face, Revenue Ruling 69-545 indicates that the interests of the poor were considered. Emergency room treatment for all and acceptance of third-party reimbursement of hospital expenses were specifically established as conditions for tax exempt status under the Ruling. As indicated previously, both of those requirements substantially benefit the poor. Furthermore, the I.R.S. had before it a treasury regulation, 1.501 (c) (3)-1 (d) (2) *supra*, which expressly provided a broad definition of the term "charitable". In light of these factors and the changed health care situation in the country as a result of Medicare, Medicaid and other government programs, of which the I.R.S. was cognizant, the promulgation of Revenue Ruling 69-545 cannot be held to constitute an "abuse of discretion".

Reversed.

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[1] 5 U.S.C. § 706 (2) (A) authorizes courts to set aside agency actions found to be "arbitrary, capricious, an abuse of discretion, or otherwise not in accordance with law".

WRIGHT, *Circuit Judge, concurring in part and dissenting in part:* I concur in Part II of the court's opinion affirming the District Court on the jurisdictional issues raised on this appeal. On the merits I would also affirm the District Court for the reasons stated in its opinion holding Revenue Ruling 69-545 invalid. *See Eastern Kentucky Welfare Rights Organization* v. *Shultz*, D.D.C., 370 F.Supp. 325 (1973).

Assuming the defendants had the legal right to eliminate the requirement that nonprofit hospitals serve indigents in order to be eligible for "charitable" tax status under the Code, I would still find Revenue Ruling 69-545 invalid because it was issued without compliance with the informal rule-making procedures required by Section 553 of the Administrative Procedure Act, 5 U.S.C. § 553 (1970). Revenue Ruling 69-545 replaced Revenue Ruling 56-185 which provided that a hospital could qualify for tax exempt status only if it was "operated to the extent of its financial ability for those not able to pay for the services rendered and not exclusively for those who are able and expected to pay." Revenue Ruling 69-545 provided "Revenue Ruling 56-185 is hereby modified to remove therefrom the requirements relating to caring for patients without charge or at rates below cost." Thus Revenue Ruling 69-545 worked a substantial change in the availability of hospital services for the poor. Yet, admittedly, neither the poor nor anyone else was given notice of the proposed change or allowed to comment on it.

The Internal Revenue Service is not expert in health care delivery needs and, consequently was unable to draw on any expertise of its own in determining to free "charitable" hospitals from their obligations under existing IRS rulings to serve the poor. Comment from disciplines more directly related to health care and poverty could doubtless have assisted the IRS in deciding whether to relax the obligations of these hospitals to the poor. In proceeding

without complying with the requirements of the Administrative Procedure Act, the IRS denied itself access to education which would have allowed it to make a more informed judgment. "Section 553 was enacted to give the public an opportunity to participate in the rule-making process. It also enables the agency promulgating the rule to educate itself before establishing rules and procedures which have a substantial impact on those regulated." *Texaco, Inc.* v. *FPC*, 3 Cir., 412 F.2d 740, 743 (1969).

APPENDIX D

UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF COLUMBIA

EASTERN KENTUCKY WELFARE RIGHTS ORGANIZATION, *et al.*

Plaintiffs

v.

GEORGE P. SHULTZ, *et al.*

Defendants

Civil Action No. 1378-71

Decided December 20, 1973

Marilyn G. Rose, Jeffrey B. Schwartz, Lauren H. Silver, Anthony Z. Roisman, Thomas Place, Peter Axelrod, Ralph Abascal, Jay-Allen Eisen and Ray Ratliff, Attorneys for Plaintiffs.

John J. McCarthy, Donald Gavin, Milan D. Karlan and Harold H. Titus, Jr., United States Attorney of Counsel, Attorneys for Defendants.

Before: Barrington D. Parker
District Judge

MEMORANDUM OPINION

In this class action against the Secretary of the Treasury and the Commissioner of Internal Revenue declaratory and injunctive relief is sought by the plaintiffs, comprising various health and welfare organizations and several private citizens, all alleging indigency and an inability to pay for hospital services. Called into question is the validity of an Internal Revenue Service (IRS or Service) policy, implemented by a revenue ruling, allowing private nonprofit hospitals to qualify as "charitable" institutions under the Internal Revenue Code of 1954 (Code) without requiring them to admit and provide free or reduced rate services to

persons unable to pay. Jurisdiction of this action lies under 28 U.S.C. §§ 1331, 1340 and 1361; 28 U.S.C. §§ 2201 and 2202, and; 5 U.S.C. §§ 702 and 703.

Plaintiffs seek a declaratory judgment that the defendants have acted unlawfully in granting tax exempt status to private nonprofit hospitals as "charitable" institutions under the Code and not requiring them to admit and provide free services to indigents. They also seek an injunction prohibiting the IRS from granting or continuing to extend tax benefits to such hospitals; to compel defendants to revoke their tax exempt status and to revoke the revenue ruling.[1]

The defendants initially moved to dismiss the complaint on the grounds that: the "Federal taxes" exemption to the Declaratory Judgment Act prevents the grant of such relief; the plaintiffs lack standing to sue; the issuance of revenue rulings may not be reviewed; the doctrine of sovereign immunity bars the suit, and, the ruling was interpretive in nature, therefore rendering the Administrative Procedure Act, 5 U.S.C. § 553 (APA), inapplicable. The motion was denied without opinion.

The matter is now presented on the plaintiffs' motion for summary judgment and the defendants' cross motion for summary judgment. The Court having considered the memoranda of points and authorities of the parties, the supporting affidavits, and the argument of counsel denies the defendants' motion and enters summary judgment on behalf of the plaintiffs.

[1] Plaintiffs also seek to compel the IRS to collect all taxes due and owing because of applications of this allegedly illegal program.

THE STATUTORY BACKGROUND

Section 501(a) and (c) (3)[2] of the Internal Revenue Code grants tax exempt status to charitable organizations; § 170 (a) to (c)[3] permits individual and corporate donors to deduct from their income tax returns contributions to certain en-

[2] The pertinent provisions of § 501 read as follows:

(a) Exemption from taxation.—An organization described in subsection (c) or (d) or section 401(a) shall be exempt from taxation under this subtitle unless such exemption is denied under section 502, 503, or 504 . . .

(c) List of exemption organizations.—The following organizations are referred to in subsection (a): . . .

(3) Corporations, and any community chest, fund, or foundation, organized and operated exclusively for religious, charitable, scientific, testing for public safety, literary, or educational purposes, or for the prevention of cruelty to children or animals, no part of the net earnings of which inures to the benefit of any private shareholder or individual, no substantial part of the activities of which is carrying on propaganda, or otherwise attempting, to influence legislation, and which does not participate in, or intervene, in (including the publishing or distributing of statements), any political campaign on behalf of any candidate for public office.

[3] Section 170, dealing with deductions by taxpayers of Charitable contributions, in pertinent part states:

§ 170. Charitable, etc., contributions and gifts

(a) Allowance of deduction.

(1) General rule.—There shall be allowed as a deduction any charitable contributions (as defined in subsection (c)) payment of which is made within the taxable year. A charitable contribution shall be allowable as a deduction only if verified under regulations prescribed by the Secretary or his delegate . . .

(c) Charitable contribution defined.—For purposes of this section, the term "charitable contribution" means a contribution or gift to or for the use of . . .

(2) A corporation, trust, or community chest, fund, or foundation . . .

(B) organized and operated exclusively for religious, charitable, scientific, literary, or educational purposes or for prevention of cruelty to children or animals . . . .

tities organized and operated for charitable purposes. Hospitals as such have never been specifically listed in either §§ 501 or 170 as institutions to be accorded favorable tax consideration and they were able to do so only by qualifying as "charities" under the Code. Under § 7805 (a) of the Code the Commissioner of Internal Revenue is empowered to promulgate necessary rules and regulations to implement the statute. These rulings set forth the official policy of the Service and are designed to guide taxpayers, the interested public and IRS officials in tax matters.[4]

Earlier IRS policy, as expressed in Revenue Ruling 56-185 which complemented § 501, provided in substance that hospitals could qualify as charities upon showing that, in addition to satisfying the other requirements of § 501, and even though permitted to assess full charges to patients capable of paying, they did not refuse treatment to indigent patients.[5] The current position of IRS which gives rise to

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[4] *See* Footnote 9, *infra*.

[5] The portions of Revenue Ruling 56-185 most relevant to this suit are:

In order for a hospital to establish that it is exempt as a public charitable organization within the contemplation of section 501(c)(3), it must, among other things, show that it meets the following general requirements . . .

It must be operated to the extent of its financial ability for those not able to pay for the services rendered and not exclusively for those who are able and expected to pay. It is normal for hospitals to charge those able to pay for services rendered in order to meet the operating expenses of the institution, without denying medical care or treatment to others unable to pay. The fact that its charity record is relatively low is not conclusive that a hospital is not operated for charitable purposes to the full extent of its financial ability. It may furnish services at reduced rates which are below cost, and thereby render charity in that manner. It may also set aside earnings which it uses for improvements and additions to hospital facilities. It must not, however, refuse to accept patients in need of hospital care who cannot pay for such services. Furthermore, if it operates with the expectation of full payment from all those to whom it renders services, it does not dispense charity merely because some of its patients fail to pay for the services rendered.

this litigation is represented by Revenue Ruling 69-545 (Ruling). The striking feature of the 1969 ruling is the removal of that condition:

"Revenue Ruling 56-185 is hereby modified to remove therefrom the requirements relating to caring for patients without charge or at rates below cost."[6]

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[6] The pertinent provisions of Revenue Ruling 69-545 are:

Section 501 (c)(3) of the Code provides for exemption from Federal income tax of organizations organized and operated exclusively for charitable, scientific, or educational purposes, no part of the net earnings of which inures to the benefit of any private shareholder or individual . . .

To qualify for exemption from Federal income tax under section 501(c) (3) of the Code, a nonprofit hospital must be organized and operated exclusively in furtherance of some purpose considered "charitable" in the generally accepted legal sense of that term, and the hospital may not be operated, directly or indirectly, for the benefit of private interests.

In the general law of charity, the promotion of health is considered to be a charitable purpose. Restatement (Second), Trusts, sec. 368 and sec. 372; IV Scott on Trusts (3rd ed. 1967), sec. 368 and sec. 372. A non-profit organization whose purpose and activity are providing hospital care is promoting health and may, therefore, qualify as organized and operated in furtherance of a charitable purpose. If it meets the other requirements of section 501 (c) (3) of the Code, it will qualify for exemption from Federal income tax under section 501 (a) . . .

Revenue Ruling 56-185, C.B. 1956-1, 202, sets forth requirements for exemption of hospitals under section 501 (c) (3) more restrictive than those contained in this Revenue Ruling with respect to caring for patients without charge or at rates below cost. In addition, the fourth requirement of Revenue Ruling 56-185 is ambiguous in that it can be read as implying that the possibility of "shareholders" or "members" sharing in the assets of a hospital upon its dissolution

Allegedly suffering detrimental effects from the Ruling, plaintiffs have leveled what can be fairly categorized as a two-pronged attack upon its validity. They assert that the promulgation of the Ruling was an *ultra vires* act in that it constituted an improper administrative alteration of Internal Revenue Code provisions, in contradiction of long standing tax policy and judicial interpretation. Alternatively, assuming *arguendo* that the defendants could have validly effectuated such a substantive change, they assert that the failure to grant them and other interested parties the opportunities to express their views, as required by the APA and the Fifth Amendment to the Constitution, demands that the ruling be vacated and its policy abandoned.

The defendants on the other hand contend first, that the plaintiffs lack standing to sue and fail to demonstrate a sufficient nexus between the action complained of and any alleged resulting injuries, and second, that the contested promulgation is outside the scope of judicial review. As to the merits, the Service maintains that the Ruling is rationally based and must be upheld.

STANDING

Under § 10 of the APA, 5 U.S.C. § 702, "[a] person suffering legal wrong because of agency action, or adversely affected or aggrieved by agency action within the meaning of

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[6] (continued)

will not preclude exemption of the hospital as a charity described in section 501 (c) (3) of the Code. Section 1.501 (c) (3) 1 (b) (4) of the regulations promulgated subsequent to Revenue Ruling 56-185 makes it clear, however, that an absolute dedication of assets to charity is a precondition to exemption under section 501 (c)(3) of the Code.

Revenue Ruling 56-185 is hereby modified to remove therefrom the requirements relating to caring for patients without charge or at rates below cost. Furthermore, requirements four has been modified by section 1.501 (c) (3)-1(b)(4) of the regulations.

a relevant statute, is entitled to judicial review thereof." This provision has been most recently interpreted in *United States* v. *Student Challenging Regulatory Agency Procedures* (SCRAP), ____ U.S. ____, 37 L.Ed. 2d 254 (1973). In that proceeding plaintiff organization, comprised of four law students, challenged the propriety of an Interstate Commerce Commission decision regarding an increase in railroad freight rates without having first prepared and considered an environmental impact statement in accordance with the National Environmental Policy Act. The Supreme Court found that the requirements of § 10 of the APA were satisfied by the litigants' allegations that the agency action would have adverse economic, recreational, environmental and aesthetic effects upon its individual members. In its ruling the Court reaffirmed and expounded upon *Sierra Club* v. *Morton*, 405 U.S. 727 (1972), which established that a person could meet the APA standing requirements only when "the challenged action had caused them 'injury in fact,' and where the alleged injury was to an interest 'arguably within the zone of interests to be protected or regulated' by the statutes that the agencies were claimed to have violated." 405 U.S. at 733. By way of clarification, the *SCRAP* Court ruled that "[a] plaintiff must allege that he has been or will in fact be perceptively harmed by challenged agency action, not that he can imagine circumstances in which he could be affected by the agency's action." ____U.S. ____, 37 L.Ed 2d at 279.[7]

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[7] As the Court noted, SCRAP's alleged injury was not, at first blush, easily demonstrable. It was alleged that the proposed rate increase would step up the use of nonrecyclable products thus requiring more natural resources to be expended from the Washington, D.C. area, where the litigants resided. This was enough, however, to overcome the court's skepticism of entertaining suits in which the pleadings were no more "than an ingenious academic exercise in the conceivable." __ U.S. __, 27 L.Ed. 2d at 270.

It was significantly noted that APA standing is not restricted to those who have been "significantly" affected by agency action. __ U.S. __, 37 L.Ed. 270-71, n. 14.

Plaintiffs, therefore, are confronted with a dual threshold test requiring of them a satisfactory demonstration that on basis of the pleadings first, they were injured as a result of the agency action, referred to as "injury in fact," and second, any such injury was to an interest protected by the law allegedly violated by the administrative action.

INJURY IN FACT

This Court has little difficulty in finding that under the *SCRAP* guidelines the plaintiffs have adequately demonstrated sufficient injury flowing from the issuance of Revenue Ruling 69-545 to afford them their day in Court.

Prior to that Ruling the policy of the Service, in a very real sense, conferred a congnizable interest to indigents by requiring hospitals seeking tax advantages under the Code to give them special consideration. It simply defies common sense to contend that the plaintiffs have remained, or will remain, unaffected by a decision which all but strips from them basic and substantial benefits which had been previously nurtured by the government. Plaintiffs and other individuals have supplied affidavits[8] recounting incidents subsequent to the present Ruling where they were denied needed hospital attention because of indigency by institutions benefiting from the applicable Code provisions and Ruling.

The government points out, and the Court is not unmindful of the fact, that plaintiffs are hard pressed to demonstrate indisputably that their inability to secure medical services was a direct consequence of the Ruling. The circumstances surrounding this litigation, however,

[8] *See* e.g., the following affidavits, filed on April 10, 1973; Eula Hall, Chairman, Health Committee, Eastern Kentucky Welfare Rights Organization; Lards Collins; Carolyn Block; Howard Linville, Treasurer, Association of Disabled Miners and Widows, Inc; Rosezella Cook; Monica Hunter.

suggest that the defendant's view of standing may be far too restrictive and unrealistic. It is obvious that while the poignant representations in the plaintiffs' affidavits do indeed reveal the severe health care crisis confronting the nation's poor, iron-clad documentation of a nexus between their tragic situation and hospital behavior towards indigents, as affected by the new Ruling, has not been and, in all probability, cannot be provided to the satisfaction of the criteria urged by the government. That observation notwithstanding, in light of the crucial significance with which hospitals regard their status as charities,[9] the Court does not consider itself engaged in wild speculation by assuming or recognizing that the relaxation of the requirements for charitable classification would necessarily effect hospital policy, in this case care for indigents, upon which such a status had been earlier dependent.[10]

[9] Considering the statement of John Alexander McMahon, President of the American Hospital Association on Tax Reform, Before the House Committee on Ways and Means, April 13, 1973, submitted as exhibit to Plaintiff's Motion for Summary Judgment. Mr. McMahon stated:

> "Voluntary non profit hospitals are, in varying degrees, dependent upon charitable contributions . . . ."

See also, "American United", Inc. v. Walters, 477 F.2d 1169 (D.C. Cir. 1969) in which the court recognized the importance of tax benefits to "charitable" organizations:

> "Because of the 'tax breaks' attendant to contributions to corporations qualifying under § 170(c) of the Code, qualification thereunder is a precious possession and removal from the Cumulative List, Organizations Described in Section 170(c) of the Internal Revenue Code of 1954 is a damaging—sometimes fatal—injury to the financial status of any 'charitable' organization." 477 F. 2d at 1177.

[10] This analysis is supported by the very purposes for the promulgation of Revenue Rulings. In an analysis of IRS procedure, a former Chief Counsel of the Service explained that the Rulings program, consisting of letters rulings (narrowly drawn to a particular set of facts) and the more general Revenue Rulings, is designed "to provide for certainty as to the tax consequences of contemplated trans-

The Court finds the correlation between agency action and injury to plaintiffs to be at least as demonstrable as that which was accepted by the *SCRAP* Court and accordingly concludes that the initial "injury in fact" requirement under the APA has been met.

INJURY TO A PROTECTED INTEREST

Satisfaction of the standing test further requires that these plaintiffs show that any "injury in fact" has also affected an interest protected under the Internal Revenue Code.

The government argues that the hospitals are the sole intended beneficiaries of the "charitable" Code provisions, claiming that the plaintiffs are "once removed" from the effects of the Code thereby leaving them outside the sphere of any interests ostensibly served by the relevant sections. This argument is too simplistic.

A review of the judicial and legislative background surrounding tax treatment for charities, as made applicable to hospitals in particular, demonstrates the weakness of their position and that plaintiffs do indeed fall within the zone of interests protected by the Code.

The prior Revenue Ruling, 56-185, represented a codification of previous Code interpretations which had been accepted and approved by the courts. In an earlier 1942 case, *Commissioner of Internal Revenue* v. *Battle Creek*, 216 F.2d 405 (5th Cir. 1942), it was held that a

[10] (continued)
actions . . . ." Rogovin, The Four R's: Regulations, Rulings, Reliance and Retroactivity A View From Within, 43 Taxes, 757, 763 (1965). These Rulings, according to Rogovin, have had a "broad impact on our national economy and on proper and reasonable tax administration." Rogovin, *supra* at 764.

It is clear that the IRS fully expects that policy promulgated by way of Revenue Rulings will effect the taxpaying public. It may be assumed, therefore, that activities relating to one's tax position will necessarily be influenced by such IRS rulings.

sanitarium could properly be classified as a charitable institution under an earlier edition of the Revenue Code. As the court there explained at 406:

> "[i]t is also usual for hospitals and sanitariums to charge those able to pay for service rendered, in order to pay the expenses of the institution, while not denying treatment to others unable to pay anything. Such institutions are classed as charitable."

Intercity Hospital Association v. *Squire*, 56 F. Supp. 472 (W.D. Wash. 1944) involved the question of whether or not two hospitals were eligible for charitable treatment. The court ruled for the hospitals involved, placing significant emphasis upon the fact that "an extremely liberal rule prevailed concerning admittance of patients without funds."

This policy continued to receive favorable judicial recognition after it had been officially promulgated by the IRS in Revenue Ruling 56-185. A decision of the Tax Court in *Sonora Community Hospital*, 46 T.C. 519 (1966), denied tax exempt status: "the mere fact that petitioner maintained a hospital does not in and of itself justify the conclusion that it was operated exclusively for charitable purposes." 46 T.C. at 525. In *Lorraine Avenue Clinic*, 31 T.C. 141 (1958), an insubstantial showing of aid to the poor proved fatal to the clinic's claim of being a charitable organization.[11]

[11] *See also* 47 ALR 3d 1191 (1971) for an analysis of tax exempt organizations. The following observation was made with regard to hospitals:

> "It is a usual practice for a hospital to charge patients who are able to pay for the services rendered in order to maintain the institution, pay off the indebtedness on its buildings, expand its facilities, or improve its services, while not denying treatment and care to patients who are unable to pay anything." 37 ALR 3d at 1223.

The annotation then surveyed numerous court rulings, both state and federal, which clearly revealed that charitable status, in the great

Congressional developments are also significant. In 1924 the Senate considered amending the "charitable" provisions of the then existing tax laws to enable health service organizations to automatically qualify for the relevant tax considerations. This proposal was not warmly received and was eventually abandoned.[12]

The matter was most recently weighed in connection within the 1969 tax reform measures which included an attempt to confer hospitals with tax exempt status without regard to indigent service. The House version of the Tax Reform Act of 1969, H.R. 13270, which carried such a revision, was purportedly proposed to alleviate the "significant uncertainty as to the content to which a hospital must accept patients who are unable to pay, in order to retain its exempt status." H.Rep. No. 413 91st Cong., 1st Sess. 43 (1969).[13] This explanation, made public on

[11] (continued)
majority of cases, depended upon the hospital showing to varying quantitative degrees, that indigent patients had been admitted and treated. 37 ALR 3d pp. 1223-1234.

[12] A proposed change to a House Bill, (H.R. 6715) under consideration by the Senate was introduced to allow for the automatic qualification of health organizations as charities. The amendment appears in parentheses:

> Any corporation, or community chest, fund, or foundation, organized and operated exclusively for religous, charitable (including preventive and constructive service for relief, rehabilitation, health, character building, and citizenship), scientific, literary, or educational purposes, etc. 65 Cong. Rec. 8171 (1924).

This attempt was prompted by a ruling of the Commissioner of Internal Revenue, II-2-1128, I.T. 1800, Int. Rev. Bull.—1.2 (1923), which required relief to the poor as a condition for charitable status. The amendment was withdrawn by its sponsor, Senator Willis. 65 Cong. Rec. 8173.

[13] H.R. 13270, 91st Cong. 1st Sess. authorized that "Section 501(c)(3) (relating to the definition of exempt organizations) is amended by inserting after 'animals', the phrase', or for the providing of hospital care,'."

August 4, 1969 by the Committee on Ways and Means, preceded by approximately two months the October 8, 1969 promulgation of Revenue Ruling 69-545. Shortly thereafter, on November 21, 1969, the Senate Committee on Finance acknowledged the new Ruling but explained why the Senate Bill would *not* incorporate this revision:

> "The Internal Revenue Service has, however, issued a ruling on October 8, 1969, indicating that hospitals, if they meet all the other requirements of § 501(c) (3), are exempt under that provision, whether or not they provide charitable services on a non-cost or low-cost basis . . . . The Committee deleted from the bill those provisions which would have conformed the Code to the result reached by the 1969 Ruling. The committee decided to reexamine this matter in connection with pending legislation on Medicare and Medicaid." S. Rep. No. 91-552, 91st Cong. 1st Sess. 61 (1969).[14]

[11] (continued)
Hospitals had actively endorsed and advocated the passage of that revision. Julius M. Greisman, Attorney for the American Hospital Association, testifying before the House Committee on Ways and Means, felt that Revenue Ruling 56-185 was difficult to administer and urged that

> ". . . the tax law should be amended to provide that any hospital is exempt so long as it is operated principally for the purpose of providing hospital care."

Hearings on Tax Reform Act of 1969, H.R. 13270 Before the House Committee on Ways and Means, 91st Cong. 1st Sess. 1425.

[14] The Senate Committee on Finance, in a Report of the Staff on Medicare and Medicaid, Problems, Issues and Alternatives, considered in early 1970 the substance of Revenue Ruling 69-545. The staff noted that prior to the Ruling, IRS policy had provided a measure of protection against any unreasonable refusal by a nonprofit hospital to provide charitable and below-cost care:

> "The staff strongly recommends revocation of Revenue Ruling 60-545 in light of the recent legislative history and continuation of the prior position of the Service until such

The Senate version, as indicated by the above cited report, omitted the proposed House change. The House Conference Committee subsequently acquiesced in this determination:

> "The House Bill provides that hospitals, if they meet all the other requirements of Section 501 (a) (3), are exempt under that provision, whether or not they provide charitable services on a non-cost or low-cost basis. The Senate amendment strikes out these provisions. The conference substitute . . . follows the Senate amendments." H. Rep. No. 91-782. 91st Cong., 1st Sess. 289-90 (1969).

The Tax Reform Act of 1969 contained no revisions on the subject.

This analysis, cursory as it may be, sufficiently highlights the point that Congress and the judiciary have consistently insisted that the application of §§ 501 and 170 to hospitals be conditioned upon a demonstration that ameliorative consideration be given poor people in need of hospitalization. The Court cannot accept the government's conclusion that these Code provisions are in no way intended to aid plaintiffs and those similarly situated. To do so one would have to disregard what has been held to be the underlying rationale for allowing charitable deduction. See *e.g. McGlotten* v. *Connally*, 338 F. Supp. 448, 456 (D.D.C. 1972), which declared unconstitutional tax advantages granted to a fraternal order which denied membership to non-white applicants. Chief Judge Bazelon, writing for a Three-Judge District Court, appropriately noted:

[14] (continued)

> time as Congress can devise an alternative approach establishing reasonable yardsticks of charitable service related to the financial capacity of a hospital. Such action by the Service would assist in protecting the availability of necessary hospital care to Medicare, Medicaid, and other poor patients." Medicare and Medicaid—Problems, Issues, and Alternatives, Report of the Staff to the Committee on Finance, U.S. Senate 91st Cong. 1st. Sess. (Feb. 9, 1973).

> "The rationale for allowing the deduction of charitable contributions has historically been that by doing so, the Government relieves itself of the burden of meeting public needs which in the absence of charitable activity would fall on the shoulders of the Government. 'The Government is compensated for its loss of revenue by its relief from financial burdens which would otherwise have to be met by appropriations from public funds.' H. Rep. No. 1860, 75th Cong. 3rd Sess. 19 (1938)."

Although the above discussion in *McGlotten* focused on § 170 deductions allowed donors, it can hardly be disputed that the granting of tax exempt status to charities, pursuant to § 501 (c) (3), rests upon the same foundation.

In view of the foregoing the Court has no trouble in concluding that plaintiffs have adequately shown that, by reason of Revenue Ruling 69-545, they have suffered injury to an interest cognizable under and protected by the "charitable" provisions of the Internal Revenue Code. The second prong of the *SCRAP* test having thus been satisfied, standing is conferred upon plaintiffs to maintain this suit.

One further observation on the standing issue seems appropriate. As a general rule, Federal court inquiry into the propriety of tax policy stems from "refund" litigation instituted by disgruntled taxpayers. Standing in those cases presents no serious problem. However, in this situation it is quite obvious that since the contested Ruling in every respect establishes criteria quite favorable to persons whose tax status will be affected, its validity could not, in all probability, be tested in that normal course. If the circumstances were reversed, i.e. were the most stringent provisions of Rev. Rul. 56-185 to overrule those of Rev. Rul. 69-545—taxpayers denied deductions and hospitals refused tax exempt status, would be afforded the opportunity of challenging the Ruling upon which that tax liability had been predicated. Indeed, those litigants would be able to

make the very sort of argument plaintiffs in this suit have presented, namely that the Ruling is contrary to statute and therefore without effect. The fact that the administration of Revenue Ruling 69-545 will not produce protesting taxpayers eager to challenge its policy and application should not immunize the Ruling from such a testing where, as shown earlier, the Code policy it purports to serve has a fundamental purpose of aiding and benefiting the class of people to which plaintiffs belong.

The Court is not unmindful of and shares the government's concern for maintaining an efficient tax structure free from potential disruption from challenges by citizens for whom that policy has no actual tax consequence. However, the case *sub judice* presents somewhat of a unique situation in that the tax law in question also bears an identifiable relationship to citizens other than those whose tax returns are immediately affected.

It is also within the context that the Court, following the principles enunciated in *McGlotten* v. *Kennedy, supra* at 452-54, concludes that the "Federal taxes" exemption to the Declaratory Judgment Act, 28 U.S.C. § 2201 and the Tax Injunction Act, 26 U.S.C. § 7421(a) do not bar this suit.[15]

AUTHORITY TO PROMULGATE REVENUE RULING 69-545

As indicated at the outset, the defendants have maintained that the Commissioner's action is not subject to review by this Court, basing this central theme upon the "discretionary action" exception to the APA, 5 U.S.C. § 701(a)(2) which provides that:

[15] In McGlotten, the purposes of the above restrictions on litigation—the smooth and efficient assessment and collection of taxes—were held not to have ben jeopardized by plaintiffs' challenge to the constitutionality of IRS policy.

That reasoning is equally applicable in this suit.

> This chapter applies, according to the provisions thereof, except to the extent that . . . (2) agency action is committed to the agency discretion by law.[16]

The Court, however, finds this provision to be inapplicable.

The Supreme Court has recently held this exception to be " . . . very narrow . . . applicable in those rare instances where 'statutes are drawn in such broad terms that in a given case there is no law to apply.' S. Rep. No. 752, 79th Cong., 1st Sess. 26 (1945)." *Citizens to Preserve Overton Park* v. *Volpe,* 401 U.S. 402, 410 (1971). To be sure, almost every administrative ruling, to some degree, flows from discretionary power vested in the executive branch. But the self-categorization of a decision as being "discretionary" does not of itself preclude court scrutiny under § 701(a)(2). The limited scope of that subsection is further evidenced by § 706 of the APA, titled "Scope of Review," the terms of which empower a reviewing tribunal to vacate administrative determinations for "abuse of discretion." The obvious implication of that provision, as Professor Jaffe has observed, is that agency action is reviewable:" . . . *the presence of discretion should not bar a court from considering a claim of illegal or arbitrary use of discretion.*" L. Jaffe, Judicial Control of Administrative Action, 374-75 (1965) [Emphasis in original].

The *Overton Park* Court keyed the applicability of this exception to whether, under a particular set of circumstances, there is law to be applied by the administrator, *supra,* 401 U.S. 410, 413, and in this vein it is difficult to imagine that the deliberative process from which the policy embodied in Revenue Ruling 69-545 emerged could be properly conducted without at least some consideration and application of the legal principles at-

[16] Subsection (a)(1) makes exception from the general rule allowing for review where "statutes preclude judicial review." The government places no apparent reliance upon this provision.

tendant to the "charitable" sections of Internal Revenue Code. Indeed, the government's insistence that the action was merely interpretative undercuts its position that the Ruling falls within the § 701 (a) (2) exception to review. To interpret is to explain, or to tell the meaning of—when action has the effect of changing or altering the terms of a statue the limits of "interpretation" have been overstepped. Any discretion incorporated into the IRS's authority to promulgate rules and regulations is necessarily limited by the understanding that Congress, not the Treasury, is responsible for the formulation and institution of basic tax policy. It is true, as a matter of jurisprudence and efficient tax administration, that courts have regularly paid deference to the expertise attributed to the IRS in tax related matters and therefore judicial interference has been reluctantly employed. However, this exhibition of restraint is predicated upon the assumption that administrative rulings will do no more than effectuate, implement and clarify the provisions of the Code which have been Congressionally enacted:

> "The power of an administrative officer or board to administer a federal statute and to prescribe rules and regulations to that end is not the power to make law—for no such power can be delegated by Congress—but the power to adopt regulations to carry into effect the will of Congress as expressed by the statute. A regulation which does not do this, but operates to create a rule out of harmony with the statute is a mere nullity." *Manhattan General Equipment Co. v. Commissioner*, 297 U.S. 129, 134 (1936).

See also *Dixon v. United States*, 381 U.S. 68, 74-75 (1965) for a more recent application of this principle. When this assumption is proven wrong, the courts must act to rectify any administrating determination which is not in accord with the Code. The ruling is therefore reviewable.

Section 706 of the APA sets forth the standards for judicial inquiry, obligating " . . . the reviewing court to engage in a substantial inquiry."[17] the initial step of which is to determine whether the administrator "acted within the scope of his authority." *Overton Park, supra* at 415, (citations omitted). The Court turns for guidance to several recent Supreme Court rulings which, although not brought pursuant to the APA, are nonetheless instructive as to the contours of IRS authority.[18]

It is settled law that the positions adopted by the Treasury are presumptively valid and will not ordinarily be interfered with by the courts. *Bingler* v. *Johnson*, 394 U.S. 741, 750-51

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[17] Section 706 provides:

To the extent necessary to decision and when presented, the reviewing court shall decide all relevant questions of law, interpret constitutional and statutory provisions, and determine the meaning or applicability of the terms of an agency action. The reviewing court shall—

(1) compel agency action unlawfully withheld or unreasonably delayed; and

(2) hold unlawful and set aside agency action, findings, and conclusions found to be—

(A) arbitrary, capricious, an abuse of discretion, or otherwise not in accordance with law;

(B) contrary to constitutional right, power, privilege, or immunity;

(C) in excess of statutory jurisdiction, authority, or limitations, or short of statutory right;

(D) without observance of procedure required by law;

(E) unsupported by substantial evidence in a case subject to sections 556 and 557 of this title or otherwise reviewed on the record of an agency hearing provided by statute; or

(F) unwarranted by the facts to the extent that the facts are subject to trial de novo by the reviewing court.

In making the foregoing determinations, the court shall review the whole record or those parts of it cited by a party, and due account shall be taken of the rule of prejudicial error. Pub.L. 89-554, Sept. 6, 1966, 80 Stat. 393.

[18] The cases generally followed the refund litigation route, which as earlier indicated, would not be available to these plaintiffs. See pages 11-12, *supra*.

(1969); *United States* v. *Correl*, 389 U.S. 299, 307 (1967).[19] That doctrine, however, is not automatically dispositive. As *United States* v. *Cartwright*, 411 U.S. 546, 550 (1973) admonished, it " . . . is to set the framework for judicial analysis; it does not displace it." The case of *Fribourg Nav. Co.* v. *Commissioner*, 383 U.S. 272 (1966) is particularly well suited to offer an analytical framework and will serve as a platform for this Court's examination.

At issue in Fribourg was the soundness of IRS policy, effectuated by a revenue ruling, concerning the sale of and deductions allowable for depreciable assets. An affected taxpayer litigated the issue to culmination with the Supreme Court declaring in his favor that the IRS position was contrary to the Code and therefore invalid. Although the actual holding is, of course, of no significance to the issues presented in this suit, the approach followed by the Supreme Court is. In reaching its determination, congnizance was taken and great weight was given to the fact that for many years the IRS had followed a fundamentally different policy which had been solidified by court as well as congressional approval.

In *Cartwright*, *supra*, the Supreme Court adopted a similar line of reasoning when it invalidated a treasury regulation in which the criteria for determining the valuation of mutual fund holdings for federal estate tax purposes was established. After carefully noting that regulations are generally upheld, Mr. Justice White proceeded to hold that the regulation in question was an unrealistic and unreasonable interpretation of the Internal Revenue Code. Referring to the Investment Company Act

[19] The Correll Court, in considering a challenge to a rule followed by the Commissioner of the Internal Revenue Service held that: "The role of the judiciary in cases of this sort begins and ends with assuring that the Commissioner's regulations fall within his authority to implement the congressional mandate in some reasonable manner." 389 U.S. at 307.

of 1940, which regulates the mutual funds field, he concluded: "Congress surely could not have intended [the pertinent section of the Code] to be interpreted in such a manner." 411 U.S. at 557.[20]

The reasonableness of Revenue Ruling 69-545, and the policy announced therein, therefore hinges upon whether or not it is in accord with the terms of the Code. As is usually the case, there is no clear cut disparity between the administrative ruling and the statutory language, making it necessary for the Court to discern the intended meaning and proper interpretation of the pertinent provisions. Following *Fribourg*, the Court will focus upon and give careful consideration to the relevant judicial, legislative[21] and administrative history. This provides little, if any, support for the government's position.

The defendants do not dispute that Revenue Ruling 69-545 represented, as did the revenue ruling in *Fribourg*, a clear change of previously administered policy. And the Court does not mean to imply that the Commissioner should be so inflexible as to be required, under all circumstances, to rigidly adhere to past practices. However, he

[20] The Court adopted the position of a dissenting member of the Tax Court which had earlier dealt with the challenge Regulations:

> "It does not follow that, because [the Commission] has a choice of alternatives, his choice should be sustained where the alternative chosen is unrealistic. In such a situation the regulations embodying that choice should be held to be unreasonable." 411 U.S. at 557, quoting from Estate of Wells v. Commissioner, 50 T.C. 871, 878 (1968).

[21] The significance of legislative intent is further conspicuously revealed in Bingler v. Johnson, *supra*. Although the Congressional history concerning the section of the Code there involved (§ 117 exclusions from income of scholarships and fellowships) was by no means crystal clear, the Court nonetheless embarked upon an analysis of the relevant congressional history, determined what it considered to be the legislature's apparent reasoning and finally ruled that the contested Treasury Regulation comported with that meaning.

may not do so without sound basis and authority. As Justice White, in his *Fribourg* dissent, observed:

> "We have frequently in the past recognized the Commissioner's authority to re-evaluate a prior position upon the basis of greater experience and reflection and to adjust that position to the extent that he becomes convinced that an adjustment is necessary *to comport with congressional intent*, even when this results in a distinct reversal of a previous position. . . ." 383 U.S. at 297 (citations omitted; emphasis added).

The government has attempted to justify the reversal of policy as to § 501(c)(3) with reference to Professor Scott's treatise on Tursts as well as the Restatement of Trusts, for which Scott is the Reporter. Rev. Ruling 69-545 itself includes such a reference.[22] Urging that modern day "community benefit" concepts of charity, viewed in conjunction with the importance of promoting general health care, serve as a sufficient and rational basis for the IRS policy,[23] the Ruling is defended as a perfectly permissible interpretative determination. For judicial support reliance is placed upon *Green* v. *Connally*, 330 F. Supp. 1150 (D.D.C. 1971) where Circuit Judge Leventhal, emphasizing federal and public policy considerations, ruled that private educational institutions that followed racially discriminatory practices towards students were precluded from enjoying tax benefits

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[22] "In the general law of charity, the promotion of health is considered to be a charitable purpose. Restatement (Second), Trust, Sec. 368 and Sec. 372; IV Scott on Trusts (3rd Ed. 1967), Sec. 368 and Sec. 372." Rev. Rul. 69-545.

[23] Two aspects of the Ruling have been noted in this regard: 1. that emergency rooms must remain available to *all* patients and 2. that persons who are able to pay by means of third party reimbursement must receive general hospital treatment. These conditions, however, are of no consequence to the Courts findings that the Service erred in effectuating the substantial changes found in the Ruling.

under §§ 501(c)(3) and 170(a) to (c). The defendants take much comfort in the following passage:

> "But clearly, the term 'charitable' is used 'in its generally accepted legal sense,' . . . and not in a street or popular sense (such as, e.g., benevolence to the poor and suffering) . . . . Thus 'strong analogy' can be derived from the general common law of charitable trusts at least for close interpretative questions . . . ." 330 F. Supp. at 1157 (citations omitted).

The emphasis given by the IRS to Scott's principles of trust law, which the Court has no reason to doubt, was misplaced and provides, even when taken in conjunction with *Green*, an insufficient basis, in view of prior legislative and judicial history, to justify the basic shift in policy. The *Green* opinion, which of course followed the Ruling and therefore serves only as an after-the-fact basis, while perhaps pertinent for general definitional considerations, can hardly justify the Commissioner's attempt to reform the Code on an issue which had acquired a significant degree of meaning and rationale of its own. It is unnecessary to repeat in full this background but it is important to emphasize that the Ruling was promulgated simultaneously with a flourish of Congressional activity on the subject, allowing one to conclude that the Service would have naturally looked to Congress for insight. The House Report, which included the controversial change, was proposed on August 4, 1969; Senate rejection came in mid-November; and House adoption of the Senate revision followed shortly thereafter.

It is readily apparent that the Ruling was issued before any *final* Congressional determination had been rendered. Although at the time of promulgation the House had adopted a measure which was supportive of the Ruling, the required Senate approval had not been given. The Senate Finance Committee, which reported on its version, not only

clearly stated that the matter would once again be reviewed in conjunction with Medicare and Medicaid legislation, it also gave some indication that the Committee members thought the Ruling to be in conflict with the Code:

> "The Committee deleted from the bill those provisions which would have conformed the Code to the result reached by the 1969 Ruling." S. Rep. No. 91-552, 91st Cong. 1st Sess. 61 (1969).

The IRS cannot satisfactorily demonstrate, by reason of this legislative activity, that it was supplied with a sufficiently convincing expression of Congressional intent as to warrant implementation of the sweeping policy change embodied in the Ruling.

The defendants claim, however, that Congress, being fully aware of the Ruling and its consequence, granted implied approval by failing to affirmatively reject it. The Court finds this argument unpersuasive. The legislative record, even if viewed in the light most favorable to the government, reveals that the Congress, which was by no means silent on the issue, felt uncertainty and doubt as to the propriety of the Ruling. Nor has the Court been apprised of anything to indicate that the Senate was amenable to the House provisions which it deleted but felt that, in view of the Ruling, any further legislative action would be superfluous.

In short, any reading of the sequence of events to establish Congressional affirmation of the Ruling is less than persuasive and is an unacceptable basis for upholding its validity.

Accordingly, the Court finds that Revenue Ruling 69-545 was improperly promulgated and is without effect inasmuch as it allows private non-profit hospitals to qualify as charities under the Internal Revenue Code of 1954

without requiring the hospitals to offer special financial consideration to persons unable to pay.[24]

In view of the above holding the Court need not reach due process questions presented under the Fifth Amendment and the Administrative Procedure Act.

Counsel for plaintiffs shall present an appropriate order within 10 days.

Barrington D. Parker
United States District Judge

December 20, 1973

[24] The Court recognizes that Revenue Ruling 69-545 makes reference only to § 501 (c)(3) and not to § 170. The Court has assumed, and the government has not argued to the contrary, that since the underlying policy considerations behind the "charitable" provisions of both sections are the same, conditions and requirements of § 501(c)(3) would apply equally to § 170.

APPENDIX E

UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF COLUMBIA

EASTERN KENTUCKY WELFARE
RIGHTS ORGANIZATION, et al.
Plaintiffs

v.

GEORGE P. SHULTZ, et al.
Defendants

MEMORANDUM ORDER

On December 20, 1973 the Court filed in this case its Memorandum Opinion. This proceeding, brought by several health and welfare organizations challenged a Revenue Ruling of the Internal Revenue Service. Before entry of the final judgment the American Hospital Association (AHA), through its counsel, sought leave to intervene as *amicus curiae* and in its application requested the Court to reconsider its Opinion. For the reasons set forth below this belated and tardy application to intervene is denied.

The complaint in this proceeding was filed on July 12, 1971, and the Government sought a dismissal on procedural and jurisdictional grounds. After full argument the motion to dismiss was denied on April 28, 1972. Cross motions for summary judgment were then filed by the parties. The issues were fully briefed and argued and on December 20, 1973 the Court entered a Memorandum Opinion finding that:

> "Revenue Ruling 69-545 was improperly promulgated and is without effect inasmuch as it allows private nonprivate hospitals to qualify as charities under the Internal Revenue Code of

> 1954 without requiring the hospitals to offer special financial consideration to persons unable to pay."

Pursuant to the opinion, counsel for the plaintiffs submitted a proposed order. Shortly thereafter counsel for the American Hospital Association, which had not been previously involved in the litigation, advised the Court by a letter dated January 8, 1974 of its concern with the potential effects the Opinion would have upon its member hospitals. He also requested the Court to delay entry of final judgment until the Association had an opportunity to file certain papers. On January 14th the AHA filed a motion, supported by an affidavit of one of its Vice-Presidents, seeking permission to intervene as *amicus curiae* and requesting a "reconsideration" of the Memorandum Opinion.

The untimeliness of the AHA's request as well as its failure to give adequate justification for any delay is most apparent. No claim is made that the AHA did not have full knowledge of the proceedings. Indeed, the affidavit candidly admits that the Association knew of this litigation since 1971 but refrained from intervening until this late date because of a belief and an assumption that procedural and jurisdictional objections interposed by the defendants would prevail and be dispositive. At no time over the course of more than two years did the AHA seek to intervene under the provisions of Rule 24, Federal Rules of Civil Procedure. Although the Government's cross motion for summary judgment revewed the procedural defenses to which the AHA now alludes, the substantative merits were unmistakenly at issue. The reasoning presented by the Association for resting on its oars for more than two years and until after an opinion had been rendered before seeking an appearance is wholly unacceptable.

Although this clear exhibition of laches is alone a sufficient basis for denying the AHA application, the Court

will comment briefly on the Association's position. The representations made in the affidavit attempt to demonstrate that Revenue Ruling 69-545 was of no ascertainable detriment to the class of persons who instituted this suit, and in this regard appear to be most appropriately addressed to the issue of standing. That question was extensively briefed and was given considerable attention. The Court is satisfied, however, with the conclusion it has reached and finds the facts offered by the AHA, even assuming *arguendo* that they are true and uncontroverted, to be insufficient to persuade the Court that plaintiffs failed to meet standing requirements. *United States v. Students Challenging Regulatory Agency Procedures*, 37 L. Ed. 254 (1973) and *Sierra Club* v. *Morton*, 405 U.S. 727 (1972).

Accordingly, it is this 28th day of January, 1974,

ORDERED that the Application of the American Hospital Association To Intervene As Amicus Curiae, be and it is denied.*

Barrington D. Parker
United States District Judge

* In view of this ruling there is no need for the Court to act upon the AHA's motion for reconsideration. It is noted however, that there is considerable doubt as to the propriety of such relief. See City and County of Denver v. Denver Tramway Corporation, 23 F. 2d 287, 295 (8th Cir. 1927).

APPENDIX F

UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF COLUMBIA

EASTERN KENTUCKY WELFARE
RIGHTS ORGANIZATION, *et al.*

Plaintiffs

v.

GEORGE P. SHULTZ, *et al.*

Defendants

Civil Action No. 1378-71

ORDER AND JUDGMENT

Plaintiffs and defendants have filed cross-motions for summary judgment concerning the legal obligations of defendants under the Internal Revenue Code with respect to the status, under sections 501(c)(3) and 170(a)-(c) of the Internal Revenue Code of 1954 (Title 26 U.S.C.), of non-profit hospitals which refuse admission and services to persons unable to pay. Having had full opportunity to consider said motions, pleadings, affidavits, and memoranda, and after hearing argument, the Court for the reasons set forth in the Opinion filed on December 20, 1973, determines that there is no material issue of fact in dispute, and expressly directs the entry of a judgment in favor of plaintiffs as follows:

I. DECLARATORY RELIEF

Declared:

1. That the defendants acted outside their scope of authority under the Internal Revenue Code of 1954 (Code) by promulgating Revenue Ruling 69-545 inasmuch as that Ruling removed previously followed requirements, found in

Revenue Ruling 56-185, that private nonprofit hospitals seeking tax exempt status as charitable organizations under §501(c)(3) of the Code must provide free or below cost treatment to individuals unable to pay for such services.

2. That Revenue Ruling 69-545, to the extent that it modifies Revenue Ruling 56-185 with regard to the requirements relating to the caring for patients without charge or at below cost rates, is void and without effect.

II. INJUNCTIVE RELIEF

Ordered, Adjudged and Decreed that defendants enjoined and restrained from:

1. Following the above voided policy contained in Revenue Ruling 69-545;

2. Granting tax exempt status under § 501(c)(3) of the Code and allowing deductions for contributions under § 170(a)-(c) of the Code to private nonprofit hospitals unless and until said hospitals:

a. Satisfy the requirements found in Revenue Ruling 56-185, in particular, that they:

> (1) be operated, to the extent of their financial ability, for those not able to pay for services and not exclusively for those who are able and expected to pay; (2) furnish the above "charitable" services on a reduced rate and below cost or no charge basis; (3) not refuse patients in need of hospital care who cannot pay.

b. Conspicuously post, in appropriate accessible public areas, notice, to be prepared by the defendants and subject to Court approval, which shall include:

(1) That the hospital has applied for or has been granted tax exempt status order § 501(c)(3) of the Code;

(2) An intelligible recitation of the previously mentioned provisions of Revenue Ruling 56-185.

The defendants shall take the necessary and immediate steps to implement this Order, including but not limited to

revoking the voided portion of Revenue Ruling 69-545 and promulgating in its stead appropriate Rulings, and shall report their progress to the Court within 60 days of the entry of this Order, and at such further time as the Court deems necessary.

The Court will retain juridiction over this case during said implementation.

Barrington D. Parker
United District Judge

January 28, 1974

APPENDIX G

PERTINENT PROVISIONS OF STATUTES AND REGULATIONS

26 U.S.C. 501. Exemption from tax on corporations, certain trusts, etc.

(a) Exemption from taxation.—An organization described in subsection (c) . . . shall be exempt from taxation under this subtitle . . . .

(c) List of exempt organizations.—The following organizations are referred to in subsection (a):

> (3) . . . Corporations, and any community chest fund, or foundation, organized and operated exclusively for religious, charitable, scientific testing for public safety, literary or educational purposes, or for the prevention of cruelty to children or animals, no part of the net earnings of which inures to the benefit of any private shareholder or individual. . . .

26 U.S.C. 170. Charitable, etc., contributions and gifts.

(a) Allowance of deduction.—

> (1) General rule.—There shall be allowed a deduction any charitable contribution (as defined in subsection (c)) payment of which is made within the taxable year. A charitable contribution shall be allowable as a deduction only if verified under regulations prescribed by the Secretary of his delegate.

(c) Charitable contribution defined.—For purposes of this section, the term "charitable contribution" means a contribution or gift to or for the use of—

> (2) A corporation, trust, or community chest, fund, or foundation—
>
> (B) organized and operated exclusively for religious, charitable, scientific, literary, or

> educational purposes or for the prevention of cruelty to children or animals. . . .

5 U.S.C. 553. Rule Making.

> (b) General notice of proposed rule making shall be published in the Federal Register, unless persons subject thereto are named and either personally served or otherwise have actual notice thereof in accordance with law. The notice shall include—
>
> (1) a statement of the time, place, and nature of public rule making proceedings;
>
> (2) reference to the legal authority under which the rule is proposed; and
>
> (3) either the terms or substance of the proposed rule or a description of the subjects and issues involved.
>
> Except when notice or hearing is required by statute, this subsection does not apply—
>
> (A) to interpretative rules, general statements of policy, or rules of agency organization, procedure, or practice; or
>
> (B) when the agency for good cause finds (and incorporates the finding and a brief statement of reasons therefor in the rules issued) that notice and public procedure thereon are impracticable, unnecessary, or contrary to the public interest.
>
> (c) After notice required by this section, the agency shall give interested persons an opportunity to participate in the rule making through submission of written data, views, or arguments with or without opportunity for oral presentation. After consideration of the relevant matter presented, the agency shall incorporate in the rules adopted a concise general statement of their basis and purpose. . .
>
> (d) The required publication or service of a substantive rule shall be made not less than 30 days before its effective date. . .
>
> (e) Each agency shall give an interested person the right to petition for the issuance, amendment, or repeal of a rule.

5 U.S.C. 706. Scope of review.

. . . The reviewing court shall— . . .

(2) hold unlawful and set aside agency action, findings, and conclusions found to be—

(A) arbitrary, capricious, an abuse of discretion, or otherwise not in accordance with law . . .

26 CFR 1.501(c) (3)-(2) Charitable defined. The term "charitable" is used in section 501(c) (3) in its generally accepted legal sense and is, therefore, not to be construed as limited by the separate enumeration in section 501(c)(3) of other tax-exempt purposes which may fall within the broad outlines of "charity" as developed by judicial decisions. Such term includes; Relief of the poor and distressed or of the underprivileged; advancement of religion; advancement of education or science; erection or maintenance of public buildings, monuments, or works; lessening of the burdens of Government; and promotion of social welfare by organizations designed to accomplish any of the above purposes, or (i) to lessen neighborhood tensions; (ii) to eliminate prejudice and discrimination; (iii) to defend human and civil rights secured by law; or (iv) to combat community deterioration and juvenile delinquency. The fact that an organization which is organized and operated for the relief of indigent persons may receive voluntary contributions from the persons intended to be relieved will not necessarily prevent such organization from being exempt as an organization organized and operated exclusively for charitable purposes. . . .

APPENDIX H

26 CFR 1.501(c)-1: Organizations organized and operated for religious, charitable, scientific, testing for public safety, literary, or educational purposes, or for the prevention of cruelty to children or animals.

Examples illustrate whether a nonprofit hospital claiming exemption under section 501(c)(3) of the Code is operated to serve a public rather than a private interest Revenue Ruling 56-185 modified

Rev. Rul. 69-545[1]

Advice has been requested whether the two nonprofit hospitals described below qualify for exemption from Federal income tax under section 501(c) (3) of the Internal Revenue Code of 1954. The articles of organization of both hospitals meet the organizational requirements of section 1.501(c)(3)—1(b) of the Income Tax Regulations, including the limitation of the organizations' purposes to those described in section 501(c)(3) of the Code and the dedication of their assets to such purposes.

Situation 1. Hospital A is a 250-bed community hospital. Its board of trustees is composed of prominent citizens in the community. Medical staff privileges in the hospital are available to all qualified physicians in the area, consistent with the size and nature of its facilities. The hospital has 150 doctors on its active staff and 200 doctors on its courtesy staff. It also owns a medical office building on its premises with space for 60 doctors. Any member of its active medical staff has the privilege of leasing available office space. Rents are set at rates comparable to those of other commercial buildings in the area.

The hospital operates a full time emergency room and no one requiring emergency care is denied treatment. The

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[1] Also released as Technical Information Release 1022, dated Oct. 8, 1969.

hospital otherwise ordinarily limits admissions to those who can pay the cost of their hospitalization either themselves, or through private health insurance, or with the aid of public programs such as Medicare. Patients who cannot meet the financial requirements for admission are ordinarily referred to another hospital in the community that does serve indigent patients.

The hospital usually ends each year with an excess of operating receipts over operating disbursements from its hospital operations. Excess funds are generally applied to expansion and replacement of existing facilities and equipment, amortization of indebtedness, improvement in patient care, and medical training education, and research.

Situation 2. Hospital B is a 60-bed general hospital which was originally owned by five doctors. The owners formed a nonprofit organization and sold their interests in the hospital to the organization at fair market value. The board of trustees of the organization consists of the five doctors their accountant, and their lawyer. The five doctors also comprise the hospital's medical committee and thereby control the selection and the admission of other doctors to the medical staff. During its first five years of operations, only four other doctors have been granted staff privileges at the hospital. The applications of a number of qualified doctors in the community have been rejected.

Hospital admission is restricted to patients of doctors holding staff privileges. Patients of the five original physicians have accounted for a large majority of all hospital admissions over the years. The hospital maintains an emergency room, but on a relatively inactive basis, and primarily for the convenience of the patients of the staff doctors. The local ambulance services have been instructed by the hospital to take emergency cases to other hospitals in the area. The hospital follows the policy of ordinarily limiting admissions to those who can pay the cost of the services rendered. The five doctors comprising the original medical staff have continued to maintain their offices in the

hospital since its sale to the nonprofit organization. The rental paid is less than that of comparable office space in the vicinity. No office space is available for any of the other staff members.

Section 501(c) (3) of the Code provides for exemption from Federal income tax of organizations organized and operated exclusively for charitable, scientific, or educational purposes, no part of the net earnings of which inures to the benefit of any private shareholder or individual.

Section 1.501(c)(3)-1(d) (ii) of the regulations provides that an organization is not organized or operated exclusively for any purpose set forth in section 501(c) (3) of the Code unless it serves a public rather than a private interest.

Section 1.501(c) (3)-1(d)(2) of the regulations states that the term "charitable" is used in section 501(c)(3) of the Code in its generally accepted legal sense.

To qualify for exemption from Federal income tax under section 501(c)(3) of the Code, a nonprofit hospital must be organized and operated exclusively in furtherance of some purpose considered "charitable" in the generally accepted legal sense of that term, and the hospital may not be operated, directly or indirectly, for the benefit of private interests.

In the general law of charity, the promotion of health is considered to be a charitable purpose. *Restatement (Second), Trusts,* sec. 368 and sec. 372; IV *Scott on Trusts* (3rd ed. 1967), sec. 368 and sec. 372. A nonprofit organization whose purpose and activity are providing hospital care is promoting health and may, therefore, qualify as organized and operated in furtherance of a charitable purpose. If it meets the other requirements of section 501(c)(3) of the Code, it will quality for exemption from Federal income tax under section 501(a).72

Since the purpose and activity of Hospital 4, apart from its related educational and research activities and purposes, are providing hospital care on a nonprofit basis for members or its community, it is organized and operated in furtherance of a purpose considered "charitable" in the generally accepted legal sense of that term. The promotion of health, like the relief of poverty and the advancement of education and religion , is one of the purposes in the general law of charity that is deemed beneficial to the community as a whole even though the class of beneficiaries eligible to receive a direct benefit from its activities does not include all members of the community, such as indigent members of the community, provided that the class is not so small that its relief is not of benefit to the community. *Restatement (Second), Trusts,* sec. 368, comment (b) and sec. 372, comments (b) and (c); IV *Scott on Trusts* (3rd ed. 1967), sec. 368 and sec. 372.2. By operating an emergency room open to all persons and is proving hospital care for all those persons in the community able to pay the cost thereof either directly or through third party reimbursement, Hospital A is promoting the health of a class of persons that is broad enough to benefit the community.

The fact that Hospital A operates at an annual surplus of receipts over disbursements does not preclude its exemption. By using its surplus funds to improve the quality of patient care, expand its facilities, and advance its medical training, education, and research programs, the hospital is operating in furtherance of its exempt purposes.

Furthermore, Hospital A is operated to serve a public rather than a private interest. Control of the hospital rests with its board of trustees, which is composed of independent civic leaders. The hospital maintains an open medical staff, with privileges available to all qualified physicians. Members of its active medical staff have the privilege of leasing available space in its medical bulding. See Rev. Rul. 69-464, page 132, this Bulletin.) It operates an active and generally accessible emergency room. These

factors indicate that the use and control of Hospital A are for the benefit of the public and that no part of the income of the organization is inuring to the benefit of any private individual nor is any private interest being served.

Accordingly, it is held that Hospital A is exempt from Federal income tax under section 501(c)(3) of the Code.

Hospital B is also providing hospital care. However, in order to qualify under section 501(c)(3) of the Code, an organization must be organized and operated *exclusively* for one or more of the purposes set forth in that section. Hospital B was initially established as a proprietary institution operated for the benefit of its owners. Although its ownership has been transferred to a nonprofit organization, the hospital has continued to operate for the private benefit of its original owners who exercise control over the hospital through the board of trustees and the medical committee. They have used their control to restrict the number of doctors admitted to the medical staff, to enter into favorable rental agreements with the hospital, and to limit emergency room care and hospital admission substantially to their own patients. These facts indicate that the hospital is operated for the private benefit of its original owners, rather than for the exclusive benefit of the public. See *Sonora Community Hospital* v. *Commissioner,* 46 T.C. 519 (1966), aff'd. 397 F.2d 814 (1968).

Accordingly, it is held that Hospital B does not qualify for exemption from Federal income tax under section 501 (c)(3) of the Code. In considering whether a nonprofit hospital claiming such exemption is operated to serve a private benefit, the Service will weigh all of the relevant facts and circumstances in each case. The absence of particular factors set forth above or the presence of other factors will not necessarily be determinative.

Even though an organization considers itself within the scope of *Situation* 1 of this Revenue Ruling it must file an application on Form 1023, Exemption Application, in order to be recognized by the Service as exempt under section

501(c)(3) of the Code. The application should be filed with the District Director of Internal Revenue for the district in which is located the principal place of business or pincipal office of the organization. See section 1.501(a)—1 of the regulations.

Revenue Ruling 56-185, C.B. 1956-1, 202, sets forth requirements for exemption of hospitals under section 501(c)(3) more restrictive than those contained in this Revenue Ruling with respect to caring for patients without charge or at rates below cost. In addition, the fourth requirement of Revenue Ruling 56-185 is ambiguous in that it can be read as implying that the possibility of "shareholders" or "members" sharing in the assets of a hospital upon its dissolution will not preclude exemption of the hospital as a charity described in section 501(c)(3) of the Code. Section 1.501(c)(3)—1(b)(4) of the regulations promulgated subsequent to Revenue Ruling 56-185 makes it clear, however, that an absolute dedication of assets to charity is a precondition to exemption under section 501(c)(3) of the Code.

Revenue Ruling 56-185 is hereby modified to remove therefrom the requirements relating to caring for patients without charge or at rates below cost. Furthermore, requirement four has been modified by section 1.501(c)(3)—1(b)(4) of the regulations.

APPENDIX I

Rev. Rul. 56-185

Criteria or tests to be met in determining whether a hospital qualifies for exemption from Federal income tax under section 501(a) of the Internal Revenue Code of 1954 as an organization described in section 501(c)(3) thereof.

Advice has been requested concerning the criteria or tests to be met in determining whether a hospital can qualify for exemption for income tax as a public charitable organization.

Section 501(c) of the Internal Revenue Code of 1954 describes certain organizations exempt from income tax under section 501(a) and reads, in part, as follows:

> (3) Corporations, and any community chest, fund or foundation, organized and operated exclusively for religious, charitable, scientific***purposes,***and no part of the net earnings of which inures to the benefit of any private shareholder or individual, and no substantial part to the activities of which is carrying on propaganda, or otherwise attempting to influence legislation, and which does not participate in, or intervene in (including the publishing or distributing of statements), any political campaign on behalf of any candidate for public office.

The only ground upon which a hospital may be held to be exempt under section 501(c)(3) of the Code is that it is organized and operated primarily for educational, scientific or public charitable purposes. Usually, the ground for exemption is that it is organized and operated for public charitable purposes. The Supreme Court of the United States in *Hendering* v. *Sanda D. Dallas, Et al,* 203 U.S. 144, Ct.D. 884, C.B.XIII-2.191 (1938), held that the provisions of law granting exemption of income devoted to charity are

organizations of the law in the taxpayer's favor, where language for motives of public policy, and are not to be narrowly construed. Thus, in regard to hospital and similar organizations, the Internal Revenue Service takes the position that the term "charitable" in its legal sense and as it is used in section 501(c)(3) of the Code contemplates an implied public trust constitued for some public benefit, the income or beneifical interest of which may not inure to the benefit of any private shareholder or individual.

In order for a hospital to establish that it is exempt as a public charitable organization within the contemplation of section 501(c)(3), it must, among other things, show that it meets the following general requirements:

1. It must be organized as a nonprofit charitable organization for the purpose of operating a hospital for the care of the sick. A nonprofit hospital chartered only in general terms as a charitable corporation can meet the test as being organized exclusively for charitable purposes. See *Commissioner* v. *Battle Creek, Inc.* 126 Fed. (2d) 405).

2. It must be operated to the extent of its financial ability for those not able to pay for the services rendered and not exclusively for those who are able and expected to pay. It is normal for hospitals to charge those able to pay for services rendered in order to meet the operating expenses of the institution, without denying medical care or treatment to others unable to pay. The fact that its charity record is relatively low is not conclusive that a hospital is not operated for charitable purposes to the full extent of its financial ability. It may furnish services at reduced rates which are below cost and thereby render charity in that manner. It may also set aside earnings which it uses for improvements and additions to hospital facilities. It must not, however, refuse to accept patients in need of hospital care who cannot pay for such services. Furthermore, if it operates with the expectation of full payment from all those to whom it renders services, it does not dispense charity merely because some of its patients fail to pay for the services rendered.

3. It must not restrict the use of its facilities to a particular group of physicians and surgeons, such as a medical partnership or association, to the exclusion of all other qualified doctors. Such limitation on the use of hospital facilities is inconsistent with the public service concept inherent in section 501(c)(3) and the prohibition against the inurement or benefits to private shareholders or individuals. It is recognized, however, that in the operation of a hospital there must of necessity be some discretionary authority in the management to approve the qualifications of those applying for the use of the medical facilities. The size and nature of facilities may also make it necessary to impose limitations on the extent to which they may be made available to all reputable and competent physicians in the area.

4. Its net earnings must not inure directly or indirectly to the benefit of any private shareholder or individual. This includes the use by or benefit to its members of its earnings by way of a distribution of profits, the payment of excessive rents or excessive salaries, or the use of its facilities to serve their private interests. If provision is made in the bylaws for dividends, exemption will not be allowed even though no dividends have been declared. Exemption will not be defeated, however, merely because the shareholders or members might possibly at some future date share in the assets upon dissolution in the absence of a case of mala fides where there appears to be a plan on the part of the shareholder or individual to acquire assets on the dissolution of the corporation.

A community hospital of the type supported partly by contributions from the general public and/or public grants from a city, county or state, normally meets the requirements of section 501(c)(3) as a public charitable organization. It is formed for the purpose of furnishing hospital facilities to all persons in the community at the lowest possible cost and necessarily accepts patients who are unable to pay for hospital facilities in order to retain the support of the community. A nominal charity record for a

given period of time in the absence of charitable demands of the community, will not affect its right to continued exemption. On the other hand, a hospital formed by one or more physicians in a community who may own the capital stock thereof or rent the hospital facilities to a corporation which they control requires careful study to determine whether it is being operated in part to serve their interest, directly or indirectly. See I.T. 2421, C.B. VII-2, 150 (1928).

A hospital formed to operate on a membership basis to provide, at fixed rates, prepaid hospitalization to its members is not a charitable organization within the meaning of section 501(c)(3) of the Code. Compare G.C.M. 22554, C.B. 1940—1,243. But exemption will not be denied merely because the hospital maintains a prepayment plan, so long as such plan is available to all persons living in the area and so long as the hospital makes available its facilities to the indigent as well as to pay patients to the same extent as any other hospital not operated for profit.

A hospital which is organized as required by section 501(c)(3) of the Code, but which engages primarily in operations foreign to its stated purposes, cannot qualify as a charitable organization under the section. Conversely, a hospital, otherwise exempt, will not lose its exempt status by reason of engaging in operations unrelated to its stated purposes if such operations may be considered as merely incidental. Such a hospital will, however, be required to file an income tax return, Form 990—T.U.S. Exempt Organization Business Income Tax Return, if its gross income (included in computing unrelated business taxable income) for the taxable year is $1,000 or more.

APPENDIX J

INCOME LEVELS FOR ELIGIBILITY FOR MEDICAID BY STATE (FAMILIES OF FOUR)

STATE	Must be covered[1]	May also cover Additional Families[2]
ALABAMA	1488	No
ALASKA	4800	No
ARIZONA	None[3]	No
ARKANSAS	1500	No
CALIFORNIA	3732	Yes
COLORADO	3144	No
CONNECTICUT	3984	Yes
DELAWARE	2760	No

[1] These figures are annualized, from the largest amount that can be paid to a family of four, each month, by State, as of July 1974 in the aid to families with dependent children program, a category which must be covered by a State participating in the Medicaid program (42 U.S.C. 1396a(a)(10)(A)). Public Assistance Statistics, September 1974, National Center for Social Statistics, Social and Rehabilitation Service, U.S. Department of H.E.W., DHEW Pub. No. (SRS) 75-031000, NCSS Report A-2(9/74).

[2] A State at its option may include in the Federal-State medicaid program, families with incomes which do not exceed 133% of the level which would make them eligible for the aid to dependent children program. (42 U.S.C. 1396a(a)(10)(C) and 1396b(f)(1)(B)(i)). The States with the "no" notation are those which include none. The States with the "yes" notation include some, which in most instances includes persons only slightly above the aid to dependent children level rather than the full 133% . Source: Division of Planning & Evaluation, Medical Services Administration, Income and Resources Levels for Medically Needy in Title XIX, Plans in Operations as of December 31, 1974.

[3] Arizona has never participated in the Medicaid program. In October 1975 it shall commence participation. As of July 1974 a family of four, to be eligible for public assistance, could have income not exceeding $2,208 a year.

STATE	Must be covered[1]	May also cover Additional Families[2]
DISTRICT OF COLUMBIA	3348	Yes
FLORIDA	1812	No
GEORGIA	1920	No
HAWAII	4788	Yes
IDAHO	3576	No
ILLINOIS	3456	Yes
INDIANA	3000	No
IOWA	3552	No
KANSAS	3984	Yes
KENTUCKY	2052	Yes
LOUISIANA	1464	No
MAINE	2016	No
MARYLAND	2712	Yes
MASSACHUSETTS	3648	Yes
MICHIGAN	4800	Yes
MINNESOTA	4440	Yes
MISSISSIPPI	720	No
MISSOURI	2196	No
MONTANA	3288	Yes
NEBRASKA	3360	Yes
NEVADA	2412	No
NEW HAMPSHIRE	4152	Yes
NEW JERSEY	4272	No
NEW MEXICO	2472	No
NEW YORK	4704	Yes
NORTH CAROLINA	2208	Yes
NORTH DAKOTA	3780	Yes
OHIO	2412	No
OKLAHOMA	2832	Yes
OREGON	4056	No
PUERTO RICO	636	Yes
RHODE ISLAND	3732	Yes
SOUTH CAROLINA	1404	No
SOUTH DAKOTA	3936	No

STATE	Must be covered[1]	May also cover Additional Families[2]
TENNESSEE	1584	Yes
TEXAS	1680	No
UTAH	3288	Yes
VERMONT	4320	Yes
VIRGIN ISLANDS	1992	Yes
VIRGINIA	3732	Yes
WASHINGTON	4032	Yes
WEST VIRGINIA	2604	Yes
WISCONSIN	4836	Yes
WYOMING	2724	No